

Peru: Technical Assistance Report—Proposals for the 2022 Tax Reform: Mining Sector Fiscal Regime, Capital Gains, and IGV on Digital Services



PERU

TECHNICAL ASSISTANCE REPORT—PROPOSALS FOR THE 2022 TAX REFORM—MINING SECTOR FISCAL REGIME, CAPITAL GAINS, AND IGV ON DIGITAL SERVICES

March 2022

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Peru

Proposals for the 2022 Tax Reform: Mining Sector Fiscal Regime, Capital Gains, and IGV on Digital Services

Roberto Schatan, Eduardo Camero, Juan Carlos Guajardo, Victor Mylonas,
and Ricardo Villalobos



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CONTENTS

ABBREVIATIONS	6
PREFACE	7
EXECUTIVE SUMMARY	8
I. INTRODUCTION	13
II. FISCAL REGIME OF THE MINING SECTOR	14
A. Mining in Peru	14
B. Recent History of the Mining Fiscal Regime in Peru	17
C. Evaluation of the Fiscal Regime for Mining	18
D. FARI Analysis of the Mining Fiscal Regime in Peru	22
E. Comparative FARI Analysis of Mining Fiscal Regimes in Peru and Other Mining Countries	24
F. Alternatives to Modifying the Mining Fiscal Regime Under Consideration by the Peruvian Government	28
G. Other Tax Aspects Applicable to Mining in Peru	40
H. Fiscal Parameters in Other Mining Countries	41
III. CAPITAL GAINS TAX	47
A. Introduction	47
B. Rental Income	50
C. Capital Gains	53
D. Dividends	60
E. Interest and Debt Instruments	67
IV. IGV ON DIGITAL SERVICES	70
A. Introduction	70
B. International Practice	70
C. SUNAT Proposal	71
References	80
BOXES	
1. Analysis of Fiscal Regimes for Extractive Industries (FARI)	18
2. To What Operating Margin Levels Does the Royalty Floor Apply?	33
3. Mining Taxes Based on Profits in Other Mining Countries	44
4. Income Subject to Income Tax in Peru (Domiciled Persons) – By Category	47
5. Tax on the Disposal of Shares on the Stock Market	57
FIGURES	
1. Foreign Direct Investment, 2005–2018	15
2. Employment in Mining, 2009–2020	15

3. Collection of Mining Specific Taxes, 2005–2020	16
4. Total Collection for the Mining Sector	16
5. Royalty and SMT Marginal and Effective Rates	20
6. Collection, Government Participation, and Rates of Return on Investment	23
7. Changes in the Tax Burden Due to Variations in Project Profitability	24
8. Average Effective Tax Rate: Peru and Other Countries	26
9. Changes in the Undiscounted Tax Burden with Varying Project Profitability	27
10. Asset Depreciation Profiles, Income Tax Base, and Income Tax Collection	29
11. Collection, Government Participation, and Rates of Return on Investment	30
12. Effect on the Tax Burden and Return on Investment Following a Change in the Royalty and SMT Base	31
13. Effects of Not Permitting a Royalty and SMT Deduction from the Income Tax Base	31
14. Effects of Raising the Royalty Floor	32
15. Effects of the Package of Measures	34
16. Average Effective Tax Rate: Peru and Other Countries, Different Regimes	34
17. Changes in the Undiscounted Tax Burden with Varying Project Profitability	35
18. Marginal and Effective Rates of the New Royalty and SMT Parameter-Setting	36
19. Application of the Royalty Floor to Various Operating Margin Levels	36
20. Effects of Changing the Royalty and SMT Parameters under Different Scenarios	37
21. Average Effective Tax Rate: Peru and Other Countries, Different Regimes	38
22. Changes in the AETR with Varying Project Profitability	39
23. Capital Income in Total Income of Natural Persons, 2020	48
24. AER on Total First and Second Category Income, 2020	50
25. First Category Income Tax AER and Alignment with the Fifth Category Rate, 2020	52
26. BVL: Annual Traded Amounts – Variable Income, 2003–2020	58

TABLES

1. Total Tax Revenue of the General Government, 2019	13
2. Central Government Tax Revenue	13
3. Peru's Position in the World's Mining Production Ranking, 2020	15
4. Depreciation Rates for Fixed Assets in Peru	19
5. Summary of Elements of Peru's Mining Tax Regime	22
6. Fiscal Regimes Modeled in the FARI Analysis	22
7. Copper Producing Countries in the Comparative Group	25
8. Main Features of Corporate Income Tax in Mining Countries	43
9. Rules for Limiting the Deductibility of the Payment of Financial Expenses	45
10. Concession Area Payments for Mining Activity	46
11. Distribution of Capital Income by Income Range, 2020	48
12. Revenue from Income Tax, by Category	49
13. Income Tax on Capital Gains – (Resident) Legal Persons, 2021	54
14. Corporate Income Tax and Withholding on Dividends (Residents and Treaties), 2021	61
15. Distribution of Company Dividends, 2017–2020	64

16. Selected Countries: Tax on the Distribution of Dividends Between Companies	65
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ANNEXES

I. Background Data on Chapter III	74
II. Mineral Price, Cost, and Production Assumptions	78

ABBREVIATIONS

AER	Average effective rate
AETR	Average effective tax rate
B2B	Business to Business
B2C	Business to Consumer
BVL	<i>Bolsa de Valores de Lima</i> (Lima Stock Exchange)
TSC	<i>Convenio de Estabilidad Tributaria</i> (tax stabilization agreement)
CIAT	Inter-American Center of Tax Administrations
EBITDA	Earnings Before Interest, Taxes, Depreciation, and Amortization
GDP	Gross domestic product
SML	<i>Gravamen Especial a la Minería</i> (special mining levy)
IDB	Inter-American Development Bank
IGV	<i>Impuesto General a las Ventas</i> (general sales tax)
IMF	International Monetary Fund
IR	<i>Impuesto a la Renta</i> (income tax)
ITAN	<i>Impuesto Temporal a los Activos Netos</i> (temporary tax on net assets)
JBÍ	<i>Jurisdicción de Baja Imposición</i> (low-tax jurisdiction)
LIBOR	London Inter-Bank Offered Rate
LIGV	<i>Ley del Impuesto General a las Ventas</i> (General Sales Tax Law)
LIR	<i>Ley del Impuesto a la Renta</i> (Income Tax Law)
LP	Legal person
MEF	<i>Ministerio de Economía y Finanzas</i> (Ministry of Economy and Finance)
METR	Marginal effective tax rate
MILA	<i>Mercado Integrado Latino Americano</i> (Latin American Integrated Market)
MSCI	Morgan Stanley Composite Index
NP	Natural person
NPV	Net present value
OECD	Organisation for Economic Co-operation and Development
PTU	<i>Participación de los Trabajadores en las Utilidades</i> (employee profit sharing)
RUC	<i>Registro Único de Contribuyentes</i> (Unique Taxpayer Registry)
SUNAT	<i>Superintendencia Nacional de Aduanas y Administración Tributaria</i> (National Superintendency of Customs and Tax Administration)
TLC	<i>Tratado de Libre Comercio</i> (Free Trade Agreement)
UIT	<i>Unidad Impositiva Tributaria</i> (unit of taxation)
USA	United States of America
VAT	Value-added tax
WBG	World Bank Group

PREFACE

In response to a request by the Ministry of Economy and Finance (MEF) of Peru, a remote technical assistance mission was carried out by the Fiscal Affairs Department (FAD) of the International Monetary Fund (IMF) from November 15 to 26, 2021, to analyze certain aspects of the country's tax regime. Discussions pertained notably to the mining sector's fiscal regime, the taxation of capital gains, and the application of VAT to digital services. The mission comprised Roberto Schatan (FAD and head of mission), Eduardo Camero (FAD), and Juan Carlos Guajardo, Victor Mylonas, and Ricardo Villalobos (external advisors).

The mission met with Minister of Economy and Finance Pedro Francke and Deputy Minister of Economy Alex Contreras. It held multiple meetings with MEF technical teams headed by, Marco Camacho, Director General of Government Revenue Policy, Miryam Yepes, Director of Economic Intelligence and Tax Optimization, Zulema Calle, Director of Income and Assets, Irene Gonzales, Director of Consumption and Taxation of Foreign Trade, and Eduardo Sotelo, MEF Advisor. Meetings on the mining sector's fiscal regime were attended by the minister's advisors, Jose de Echave, Armando Mendoza, and Victor Torres. Officials from various departments of the National Superintendency of Customs and Tax Administration (*Superintendencia Nacional de Aduanas y de Administración Tributaria* –SUNAT), headed by Palmer de la Cruz, National Strategies and Risks Intendant, also took part in the various meetings. A number of meetings were attended by observers, including Luisa Charry, Senior Economist from the IMF Western Hemisphere Department, and World Bank staff. The mission also met with officials from the Ministry of Mining, Alfredo Rodriguez, Director General of Mining, and Walter Sanchez, Director of Promotion. Lastly, the mission met with representatives of the National Society of Mining, Petroleum, and Energy (*Sociedad Nacional de Minería, Petróleo y Energía* – SNMPE), Lima Stock Exchange executives, and tax specialists from EY and PwC.

The mission is grateful to the authorities for their extensive and kind cooperation.

EXECUTIVE SUMMARY

In October 2021, the MEF asked Congress for the delegation of powers to legislate on tax matters with the aim of increasing tax collections and doing so by adding progressivity to the Peruvian tax system. The initiative being developed by the MEF contains (tentatively, to date) around 40 specific measures—some administrative, others related to tax policy—that the MEF hopes will, as a whole, generate additional revenue for the treasury. The tax collection impact of quite a few of the measures (including those pertaining to the mining sector) has not been estimated, whereas the measures for which there is a calculation are estimated to bring in a little over 1 percent of GDP in revenues.

Given Peru's low level of tax collections, both relative to its own historical trends as well as those of other countries in the region, the amount expected to be collected with the proposed reform is modest. However, increasing tax collections by enhancing progressivity would appear to be the right approach.

The MEF sought advice from the IMF to develop three important aspects of the tax reform plan: (i) the mining sector regime; (ii) the income tax on capital gains; and (iii) VAT on the importation of digital services.

Peru is a preeminent mining country, and the sector makes a significant contribution to the country's public finances, ranging from 1 to 3 percent of GDP. The balance between the possibility of taxing economic rents generated by the sector, especially in periods of rising mineral prices, and maintaining a competitive regime for large-scale foreign investment is particularly delicate. The first chapter of this report examines precisely how the tax burden on the profits of a representative mining project in Peru compares with the same project in other countries with a developed copper mining industry. This approach is used to model the effect that the various fiscal regime changes being considered by the government would have on Peru's relative position to its mining competitors, acknowledging that the tax burden is just one of the determinants of Peru's competitiveness as a destination for mining investment.

One key finding of this examination is that Peru's current fiscal regime is competitive mainly due to the use of specific profit-based taxes. The total, undiscounted tax pressure (or the effective tax burden), considering profit sharing payments to workers for a representative large-scale copper project, is 41.7 percent of the profit (cash flow). This and comprises the range of contributions that companies in the sector pay, such as income tax, dividend withholding taxes, royalties, the special mining tax, and employee profit sharing (which creates a wedge between the company's tax burden and the tax collections that reach the treasury). This percentage is in the mid-range of the sample of 15 fiscal regimes in the group of comparable countries. A relevant point of this comparison is that the tax burden in Peru is higher than the one in Chile (its closest competitor in copper projects).

The second key point is that the regime permits some (moderate) space for increasing the sector's tax burden without losing international competitiveness. However, the manner in which this increase occurs is very important. It is equally important for the reforms proposed by the government not to change the ranking of Peru's tax burden relative to its competitors. The recommendation of this report is that only the rates of levies based on operating profits (royalties and the special mining tax) should be (moderately) changed. It is not recommended to change the base of these levies, either by limiting the deduction for the depreciation of fixed assets or eliminating the Royalty deduction from the income tax base. It is recommended to maintain the immediate deduction of exploration expenses in the income tax base.

If the decision is made to raise the Royalty floor (calculated as a percentage of gross income), it is recommended that the increase be moderate and, under no circumstances, more than 1 percentage point. Anything above that could lead to sudden jumps in the tax burden, causing the scale of progressive rates on operating profits to apply to a very small set of companies. Consideration could also be given to slightly increasing the marginal rates of the special mining tax, thus making the system more progressive. The report provides various scenarios in that regard.

The second chapter of the report discusses various options for strengthening the capital gains tax regime (first and second category of income). The capital gains tax regime is commonly less onerous relative to the one applicable to employment income, to address capital mobility and mitigate the impact it would have on investor profits when combined with the corporate income tax. However, the tax regime must also incorporate equity considerations.

Income and capital gains in Peru are highly concentrated among top earners. A broad SUNAT sample shows that taxpayers who are natural persons with reported income greater than 40 units of taxation (*Unidades Impositivas Tributarias* – UIT), accounting for less than 1 percent of the total number of taxpayers, earn 75 percent of the sum of first and second category income. The tax on these income categories is regressive by design because the rate is the same (and modest) as income rises. As a matter of fact, the average effective tax rate decreases slightly for those with higher capital income.

Despite the wide range of tax systems in place internationally, Peru's regime appears generous in comparison. In the sample of countries examined, the withholding tax rate on distributed dividends, for example, fluctuates mainly between 7 and 10 percent, whereas capital gains from the disposal of assets are often subject to a tax rate above 10 percent. In other countries, income and capital gains are subject to the general income tax regime for natural persons, that is, a progressive schedule of marginal rates and income brackets. In some countries considerable exemptions are also granted, for example, on gains from the sale of shares in the domestic stock market.

Although the (moderate) increase in the tax burden on first and second category income seems like a legitimate tax policy proposal, at least in terms of equity considerations, it is also true that its additional contribution to government revenue is relatively minor. For several years, taxation of first and second category income has contributed roughly 0.4 percent of GDP, which is why an increase in the tax burden for these incomes will likely not be macro-critical. International comparisons of

revenue performance are not a very good reference point, because many countries do not record revenues from capital gains taxes separately from data on income tax revenues. However, for those that do separately report revenue collections from capital gains taxes, these typically represent a fraction of a percentage point of GDP (except for a couple of countries, including the United States, which collects a little over 1 percent of GDP).

The government's intention to raise (and standardize) to 10 percent (as a maximum) the rate applicable to income and capital gains could be justified on equity and (albeit marginally) revenue-raising grounds. However, there is room for improvement in some aspects of the regime's neutrality. This report discusses the main ones below.

Leases. Even if the rate is raised to 10 percent, the regime would still disproportionately favor legal persons as lessees, since they would be able to deduct the rental expense at 29.5 percent. It is recommended that rental income be subject to the progressive rate under the general income tax regime for natural persons. It is also proposed to reduce the 30-percent deduction available to lessees, which is in large part a regressive component of the current system.

Sale of real estate. In order to achieve an effective 10-percent rate increase, the 20-percent general deduction, which is a statutory rate cut for all intents and purposes, must also be eliminated. Without it, the 10 percent nominal rate would only be an 8 percent effective rate. The broad exemption on the sale of residential housing undermines the collection potential of this tax. A more progressive system would consider a limit on the exempted gain (for example, approximately US\$200,000 in Mexico or US\$250,000 for an individual in the United States, or double for a married couple).

Sale of shares. Regardless of the rate, a important decision is whether the exemption on the Lima Stock Exchange (*Bolsa de Valores de Lima* – BVL) will be preserved. The stock exchange was not always exempt, and the current benefit expires in 2022. There is no strong evidence that the tax, when in effect, markedly affected the annual traded amount of variable-income securities. One option is to allow the benefit to expire and apply the same flat 10-percent rate to the gain. The determination of the tax base would have to be corrected as well, eliminating the 20-percent general deduction and allowing the adjustment of the acquisition cost for inflation. Lastly, the financial market includes a range of fixed-income instruments that are exempt, which would compete with a advantage against the variable-income market; in the medium term, consideration should be given to taxing these fixed-income instruments as well.

Dividends. The rate applicable to dividend distribution should be the same as for capital gains. At the same time, some current loopholes conducive to tax evasion in the legislation should also be closed. Transferring profits by manipulating transfer prices or overpaying interest should be corrected not only by imposing corporate income tax on the difference (with the market value), but also by characterizing this difference as a presumptive dividend distribution and taxing it at the dividend rate. The same should apply to loans to family members of partners or shareholders, which are not currently subject to any restrictions, except for the minimum interest payment.

Lastly, the report discusses the advantage of taxing the distribution of dividends between legal persons. This option, which in principle is only a tax advance, would mean that the first distribution would be taxed, with a credit granted down the intragroup chain until the dividend to the ultimate shareholder is paid. This is not a common practice internationally because it restricts the free flow of resources for the financing of new investments within the group. If established, it would also require special administrative control to track the credits throughout the chain within the group of companies. Peru does not currently have a control system in place requiring any dividend distribution (or advance) to have paid corporate income tax first.

Interest. The reform does not envisage measures to modify the regime applicable to interest, which grants individuals a broad exemption. This adds one more regressive component to the tax system. Not all interest paid by the financial sector is taxable, including savings instruments offered by insurance companies. Public debt interest is not taxed either. The economic effect of this benefit is that private investors compete at a disadvantage for households' savings, potentially hurting private investment. Taxing interest is complicated, however, especially due to its inflationary component. Taxing interest without an adjustment for inflation could lead to a regime that taxes the wealth of small savers who often have negative real returns. One possible (partial) solution is to exempt deposits below a certain threshold, although this entails its own problems. In any case, the recommendation is that a reform of the interest regime, focused on limiting existing exemptions, will have to be considered in the medium term.

Lastly, the third chapter of this report discusses the application of the general sales tax (*Impuesto General a las Ventas* – IGV) on digital services imports. Various international organizations have published guidelines and manuals describing tax policy consensus and options in this regard. The proposal being developed by Peru's tax authority reflects this consensus, proposing voluntary registration and simplified remote access for providers without a physical presence in the country so that they can withhold and remit IGV from abroad. The proposal includes a withholding mechanism for payments made by consumers of such services through the financial system in cases where the provider fails to pay the tax directly. This initiative broadens the tax base and injects greater neutrality into the IGV regime, insofar as equivalent domestic services are normally taxed (and when they are exempt, efforts will have to be made to maintain neutrality).

A major technical difficulty is how to precisely define the universe of digital services subject to the tax collection mechanism, given the variety of business models that exist in the market. The recommendation is for the general definition of "taxed digital service" introduced in the law to be accompanied, potentially in a regulation, by an explicit list of taxed services and another of untaxed services in order to provide operators with legal certainty. The initiative does not intend to substitute the current IGV exemption on expedited shipments (up to US\$200 per shipment), which has gained increasing importance with the growing popularity of online shopping, with a similar mechanism where the shipping service provider withholds this tax. However, an obstacle to this option is the interpretation of the Free Trade Agreement with the United States, which would protect the IGV exemption on parcel imports from that country. It is recommended to re-examine this interpretation

and take advantage of the simplified remote IGV payment compliance regime to close potentially large gaps in the areas of tax avoidance and informality. This measure is preferable to simply reducing the exempt amount, which will lead to higher customs administration costs.

I. INTRODUCTION

1. **Despite successful macroeconomic performance, tax revenue in Peru has lagged behind.** Tax collection is comparatively low relative to other countries in the region (Table 1). While significant efforts to improve tax administration have been made in recent years (Rojas et al., 2017a, and Rojas et al., 2017b), tax collections are still at a record low. As a matter of fact, collections fell just prior to the pandemic (Table 2). As stated in previous reports (Schatan et al., 2019), this limits the expansion of infrastructure and social development programs.

Table 1. Total Tax Revenue of the General Government, 2019

Country	% GDP
Brazil	24.6
Argentina	22.9
Uruguay	21.4
Chile	19.2
Honduras	18.5
Colombia	17.8
Costa Rica	15.5
Peru	14.6
Mexico	14.2
Dominican Republic	13.5
Average, excl. Peru	18.6
OECD average	23.9

Source: OECD Global Revenue Statistics Database. Note: Excludes government revenue from social contributions.

Table 2. Central Government Tax Revenue
(In percent of GDP)

	2014	2019	2020
Total	16.6	14.4	13.1
Income tax	7.0	5.7	5.4
General sales tax	8.8	8.2	7.8
Selective consumption tax	0.9	1.1	1.0
Import tax	0.3	0.2	0.2
Other tax revenue	1.5	1.5	1.2
Refunds	-1.9	-2.3	-2.4

Source: Prepared by the IMF mission with SUNAT data (tax note).

2. **The general design of the tax regime has been fundamentally maintained.** However, the underpinnings of the regime have lost collection capacity. Even before the pandemic, income tax (*Impuesto a la Renta* – IR) revenue had fallen by 1.3 percentage points of GDP and IGTV collection, by 0.6 percent. This is due largely to the economic recovery measures between 2014 and 2016, which included cuts in the main taxes.¹

3. **In October 2021, the incoming administration suggested adopting a series of tax measures to boost the government’s collection capacity.** The set of measures is estimated to increase collection by just over 1 percent of GDP, mainly based on income tax reforms. The strategy is to raise tax revenue by enhancing the progressivity of the tax system.

4. **A central aspect of the reform initiative is to examine the tax burden on the mining sector.** The mining industry is a key pillar of the Peruvian economy, and its contribution to public

¹ For example, corporate income tax was reduced from 30 to 28 percent (2015–2016), a new regime was introduced for small and medium-sized enterprises that reduced the corporate income tax rate to 10 percent (2016), and the IGTV rate and withholding coverage were reduced, which also affected the level of compliance (2014).

finances is equally important, ranging from 1 to over 3 percent of GDP depending on the year. The MEF is considering various options to modify the current regime so that taxation captures a larger proportion of the sector's extraordinary income, especially in times of rising prices, while ensuring that the sector's international competitiveness is not affected. Revenues that would be collected from this reform have not been estimated.

5. **The MEF requested technical assistance from the IMF to develop some of the aspects of the proposed fiscal reform it will be presenting in detail to Congress in December 2021.** The areas in which support was requested are: (i) the fiscal regime of the mining sector; (ii) income tax on capital gains; and (iii) IGV on digital services. This report therefore goes beyond evaluating the reform package as a whole to discuss design issues in relation to the taxes mentioned above. Chapter II of the report examines how various modifications to the mining fiscal regime would affect the effective tax burden of a large-scale mining investment project in Peru compared to the same investment in competitor countries. Chapter III analyzes various options to strengthen the taxation of income and capital gains, improving the system's progressivity as a priority. Finally, chapter IV considers options for applying the IGV to digital services imports, a proposal that the authority has been developing for a number of years. At the end of each chapter is a brief list of the mission's recommendations for the topics covered.

II. FISCAL REGIME OF THE MINING SECTOR

A. Mining in Peru

6. **Peru is a preeminent mining country, the world's second largest producer of copper and silver, and the top producer of gold, zinc, lead, and tin in Latin America.** Mining activity in Peru has been an important part of the country's economy throughout its history. In 2020, Peru was the world's second largest exporter of copper and silver and the top gold producer in Latin America (Table 3). Moreover, Peru has the world's largest silver reserves, second largest copper reserves, and fourth largest gold reserves.

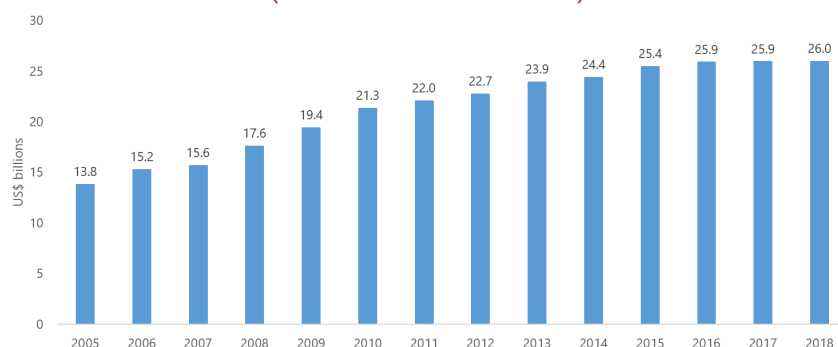
Table 3. Peru's Position in the World's Mining Production Ranking, 2020

Product	Latin America	World	Top positions in the world
Copper	2	2	Chile (1st), China (3rd)
Gold	1	8	China (1st), Australia (2nd), Russia (3rd)
Zinc	1	3	China (1st), Australia (2nd)
Lead	1	4	China (1st), Australia (2nd), United States (3rd)
Tin	1	4	China (1st), Indonesia (2nd), Myanmar (3rd)
Silver	2	2	Mexico (1st), China (3rd)
Molybdenum	2	4	China (1st), Chile (2nd), United States (3rd)

Source: Peruvian Economy Institute, "Contribución de la Minería en la Economía Nacional," March 2021.

7. **Peru is an attractive country for foreign investment in mining.** A series of reforms have been adopted since the 1990s to open up mining to foreign private investment. Between 2005 and 2018, foreign investment was on the rise, reaching US\$26 billion in 2018 (Figure 1).

Figure 1. Foreign Direct Investment, 2005–2018
(In billions of U.S. dollars)

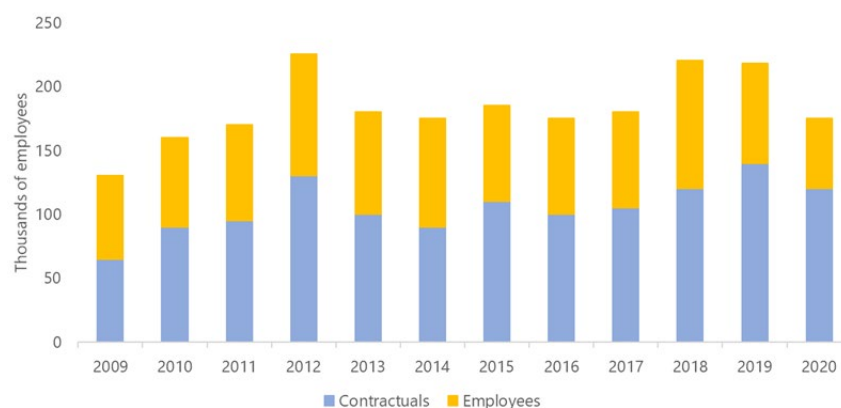


Source: EY, "Peru's Mining & Metals Investment Guide 2020/2021."

8. **The mining sector is one of the country's main economic drivers, accounting for 10 percent of GDP in the last decade.** In 2015, mining contributed 1.2 percentage points of total growth (3.3 percent). In 2016, that contribution rose to 1.8 percentage points of a total of 4 percent, reaching 0.5 percentage points in 2017. These results are mainly due to higher copper production in the Cerro Verde and Las Bambas mines.

9. **Mining is the largest exporting sector, accounting for 58 percent of total exports between 2011 and 2020 and plays an important part in job creation.** Copper represents 46 percent of total mining exports, followed by gold at 33 percent. Mining not only creates direct jobs, but also forges linkages with other economic activities, averaging close to 200,000 direct jobs over the past decade (Figure 2).

Figure 2. Employment in Mining, 2009–2020



Source: Peruvian Economy Institute, "Contribución de la Minería en la Economía Nacional," March 2021.

10. **Revenue collections from mining amount to close to 3.5 percent of GDP.** Collection from mining royalties was substituted in 2011 with a profit-based tax called the special mining levy (*Gravamen Especial Minero* – SML). In 2014, collection from mining royalties stemmed from contractual royalties established in some projects that are not generally applicable. At present (Figure 3), collection is dominated by the Mining Royalty (*Regalía Minera*) and the special mining tax (*Impuesto Especial a la Minería* – SMT). In terms of GDP, total collection from the mining sector has fluctuated with mineral prices. Levels close to 3.5 percent of GDP in 2007 fell to less than 1 percent of GDP in 2015 and 2016, only to rebound with the price cycle and return to the 3 percent expected by the MEF in 2021 (Figure 4).

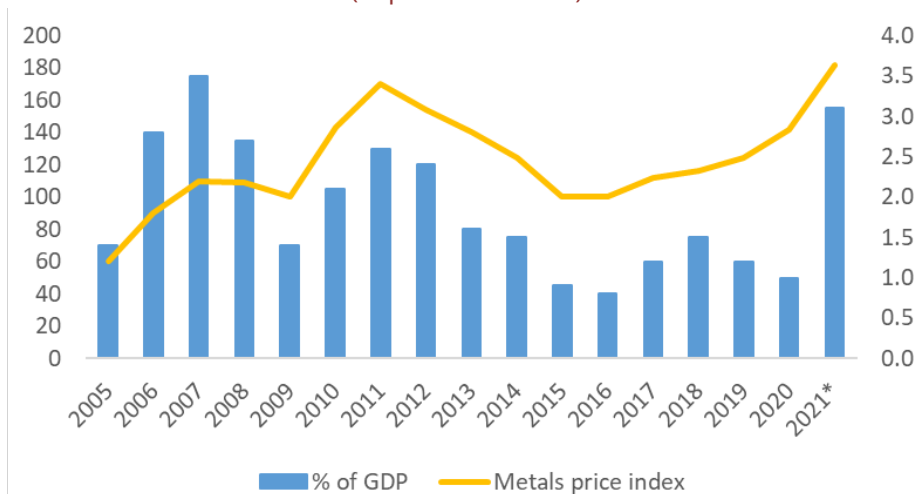
Figure 3. Collection of Mining- Specific Taxes, 2005–2020
(In millions of soles)



(*) Up to September 2021

Source: Ministry of Economy and Finance.

Figure 4. Total Collection for the Mining Sector
(In percent of GDP)



(*) Until September 2021

Source: Ministry of Economy and Finance.

B. Recent History of the Mining Fiscal Regime in Peru

11. **Until 2004, the Peruvian tax system was based on the corporate income tax and dividend distribution tax.** In 2004, an increasing royalty from 1 to 3 percent was introduced, calculated on sales. The Mining Royalty was defined as economic compensation for the exploitation of metallic and non-metallic mineral resources in Peru and was applied immediately to mining companies without valid tax stability contracts. In its first iteration, the Royalty had the following main features:

- Tax base: Gross sales value less transportation, storage, loading, and stowage costs as well as other costs and expenses assumed by the exporter.
- Tax rates and persons covered: Increasing rates between 1 and 3 percent depending on the sales made by mining concession holders. Small producers and artisanal miners (defined according to the concession surface area and the installed productive capacity) had a rate of 0 percent.

12. **Between 2006 and 2011, an additional royalty existed on net profits.** With the aim of increasing the mining sector's contribution to its areas of influence, the government reached an agreement with mining companies in late 2006 for a "voluntary, extraordinary, and temporary economic contribution." The signing of agreements for this contribution was voluntary, and for a maximum period of five years (2007–2011). The main characteristics of this contribution were as follows:

- Tax base: The tax base was the companies' taxable income from the previous year, and payment was made only if international prices were higher than the average for the last 15 years.
- Tax rates and persons covered: 40 mining companies signed agreements with the Peruvian State to make the contribution, with an effective rate of 1.75 percent for companies that paid royalties and 3.75 percent for companies that did not (due to the application of the tax stability agreement).

13. **With the expiration of the voluntary agreements, the mining fiscal regime was reformulated.** In September 2011, the following changes were made to the 2004 version, which continue to be in effect:

- Taxable base: The Mining Royalty is calculated on the operating profit, with increasing rates according to the operating margin and a floor equivalent to 1 percent of gross sales.
- Creation of the SML, calculated on the operating profit and with increasing rates according to the operating margin, applicable to companies with projects under tax stability contracts, and
- Creation of the SMT, calculated on the operating profit and with increasing rates according to the operating margin, applicable to companies without tax stability contracts.

C. Evaluation of the Fiscal Regime for Mining

14. **The fiscal regime is evaluated using the IMF's Fiscal Analysis of Resource Industries (FARI) methodology.** FARI is a model developed by the IMF to quantitatively analyze the impact of the fiscal regime on a mining investment project and to draw a comparison with other fiscal regimes, both those of other mining countries and those under different parameterization options (Box 1). The main analysis of Peru's fiscal regime entails three representative mining projects: (i) a large-scale copper extraction project; (ii) a medium-sized gold extraction project; and (iii) a medium-sized silver, lead, and zinc project. Generally speaking, the results of the analysis are consistent across the various projects, which is why only the copper project results are typically presented. The assumptions about the main parameters as well as the mineral price assumptions are discussed in Annex II.

Box 1. Analysis of Fiscal Regimes for Extractive Industries (FARI)

The FARI methodology uses a discounted cash flow model to analyze the performance of fiscal regimes for extractive industries, considering the interactions between the different instruments. The methodology is closely aligned with the practice in extractive industries of using discounted cash flow models to inform their investment decisions.

From the government's perspective, the key parameters analyzed by the FARI model are the average effective tax rate (AETR), the marginal effective tax rate (METR), and the progressivity of the fiscal regime. From an investor's perspective, the key indicators are the project's net present value (NPV), the post-tax internal rate of return (IRR), and the payback period. Fiscal regimes can be compared with international peers and alternative price, cost, and production scenarios.

However, like any model, the instrument is a simplification of reality. For example, it uses the same investment project when projects can be expected to differ between countries. It also does not evaluate the effects of differences in political-legal risk profiles between countries.

For more information, see: <https://www.imf.org/external/np/fad/fari/>.

15. **The mining fiscal regime has been in effect since 2011, when changes were introduced to increase its progressivity.** Mining activities are subject to general income tax, even though projects developed under a tax stability agreement have a higher income tax rate and benefit from an accelerated depreciation regime. Moreover, as mentioned earlier, there are two taxes specific to mining with operating profit as the base: the Mining Royalty and the SML/SMT.

16. **The income tax rate and the asset depreciation rates depend on whether the mining project is subject to a tax stabilization agreement (*convenio de estabilización tributaria* – TSC).** The general income tax rate is 29.5 percent. For projects with a tax stability agreement, the rate is two percentage points higher than the rate in effect at the time of signing. For mining, accelerated depreciation rates are applied (Table 4). In general, investors can immediately depreciate exploration and pre-operating expenses.

Table 4. Depreciation Rates for Fixed Assets in Peru

Property, plant, and equipment	Maximum annual depreciation rate		
	A. According to Mining Law	B. According to Income Tax Law, for mining	C. According to Income Tax Law, general regime
Buildings and structures	5%	5%	5%
Mining machinery and equipment	20%	20%	10%
Land transport vehicles, furnaces	20%	20%	20%
Data processing equipment	20%	25%	25%
Office furniture, fixtures, and equipment	20%	10%	10%
Other fixed assets	20%	10%	10%

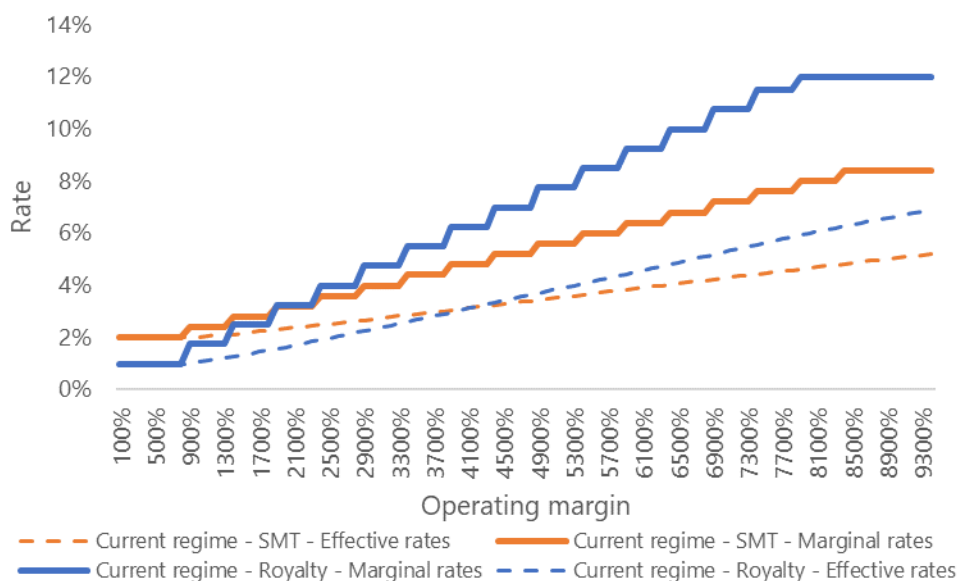
Source: Ministry of Economy and Finance.

17. **For the FARI analysis, and for both projects governed by the Income Tax Law and projects with a TSC, the entire investment is assumed to depreciate over five years.** This is due to the fact that none of the mining projects used in the analysis present disaggregated information allowing for the application of various depreciation rates as shown in Table 4 for each investment category. A flat depreciation rate is therefore applied to all categories as a simplification in the FARI analysis.

18. **Two specific taxes are applied to mining activities based on operating profit.** Operating profit is defined as income from the sale of minerals, less the cost of sales and operating expenses, including sales and administrative expenses, calculated based on accounting standards. To calculate the Royalty and SMT, whose base is calculated with accounting depreciation, the company is assumed to depreciate its fixed assets over 10 years, in line with the assumptions in the technical report of one of the copper investment projects. Applied to the operating profit is a marginal rate that increases with the operating margin, calculated as the ratio between the operating profit and income for the period. The marginal rate of the SMT and Royalty (Figure 5) is applied to the corresponding operating margin tranche. For projects with a TSC signed prior to 2011, only the SML is applied.

19. **The marginal rates on the Royalty and SMT rates are significantly higher than the effective rates.** The effective rates are calculated by applying each marginal rate to the operating margin tranche. This way, despite jumps in marginal rates when the operating margin changes (solid lines in Figure 5), the effective rates avoid these jumps and evolve continuously (dotted lines in Figure 5), which is desirable since disproportionate increases in the tax burden are avoided when moderate changes occur in the operating margin. One implication of this is that even by reducing the number of marginal rates and operating margin tranches, the effective rates will continue to avoid sudden jumps.

Figure 5. Royalty and SMT Marginal and Effective Rates



Source: Own FAD mission compilation.

20. **One particularity in Peru is employee profit sharing.** The amount distributed is calculated on the balance of the taxable income for the year after losses from previous years have been offset. The share percentage is 8 percent and is delivered as a share of the profit to company employees. This is a general obligation not specific to the mining sector and is deductible from income tax and, as part of the sales cost, from the Royalty and SMT base.

21. **It is not entirely clear whether this obligation, or at least this obligation in its entirety, must be considered in calculating the company's tax burden.** On the one hand, the analysis of fiscal regimes for extractive industries does not normally include social security contributions or other labor costs. Workers' expectation to receive a profit-sharing amount should influence the salary they are willing to receive, which is why the incidence of employee profit sharing (*Participación de los Trabajadores en las Utilidades* – PTU) must, at least partially, be on the wages of mine workers. This is why the obligation to pay PTU will at most be partially reflected as a tax burden.

22. **Nevertheless, the PTU is a legal obligation for companies, even if the government does not receive all the resources.** In Peru, the PTU a worker receives is limited to a maximum of 18 months of salary. If it is above this amount, the balance is deposited in a central government fund (Fondoempleo) that finances entrepreneurship and training projects and labor insertion. The PTU therefore has the characteristics of a tax obligation, especially in high price scenarios when profits are higher.² There is also an additional burden of 0.5 percent of taxable income to fund mining

² Information provided to the mission by the SNMPE suggests that the amount sent to Fondoempleo has not been very significant historically, not unlike contributions to regulators, which represent 0.24 percent of mining company sales. This suggests that most of the PTU is distributed to workers.

workers' pensions. The FARI analysis presents a case with and without the PTU, which is modeled with a rate of 8.5 percent for the sake of simplicity.

23. **In Peru, two contributions are charged on sales to finance the operations of the technical regulator (OSINERGMIN) and the environmental authority (OEFA).** These two charges are included in the analysis to calculate the tax burden, with a combined rate of 0.24 percent.

24. **Peru offers mining companies the possibility of entering into various types of stability agreements.** These stability agreements are concluded between mining companies and the State, under two modalities:

- *Stability under foreign and private investment legislation:* Stability contracts signed with the investment promotion agency (Proinversión), valid for 10 years. Freezes the income tax rate at the level in effect at the time of signing and offers other non-tax benefits. Requires a minimum investment of US\$10 million for two years after the contract is signed.
- *Stability under the General Mining Law:* Mining concession holders may be entitled to a wider range of stability benefits valid for 10, 12, or 15 years, depending on investment size and production capacity. The agreements freeze the tax rates and the methods of calculating the main government taxes, royalties, and other similar payments that are in effect on the date of signing of the contract. These agreements raise the income tax rate by 2 percentage points. For projects stabilized prior to 2012, the SML substitutes the Royalty and SMT.

25. **Nevertheless, the wide variety of tax parameter combinations that coexist in Peru (Table 5) are modeled according to three fiscal regimes (Table 6) for the FARI analysis.** To measure the tax burden that a new mining investment project would face in Peru, the first regime analyzed is the "Current" regime, which assumes that it does not enjoy fiscal stability and pays taxes according to the general income tax, Royalty, and SMT regime. In the second instance, this same regime is analyzed without the inclusion of the PTU ("Current without PTU"). Depending on the incidence of the PTU, the results will fall between these two extremes. Lastly, and for reference purposes only, a ("TSC") fiscal regime is modeled that would apply to a stabilized project in operation prior to 2011 with an income tax rate of 32 percent (the rate in effect before 2011 plus 2 percentage points), accelerated depreciation rates, and the SML instead of the Royalty and SMT.

Table 5. Summary of Elements of Peru's Mining Tax Regime

Item	Rate	Taxable base	Comments	
Income tax	29.5% (TSC: + 2 pp)	Taxable income	✓	Rate of 29.5% and 32% with TSC
VAT	18%	Sale value	✗	Not included
SMT	2% to 8.4%	Accounting operating profit	✓	
ITAN	0.4%	Net asset value > S/. 1 million	✗	Not included
Dividend withholding tax	5%	Distributed dividends	✓	
Royalty	1% to 12% – Minimum 1% of sales	Operating profit	✓	
SML	4% to 13.12%	Operating profit	✗	Rate of 29.5% and 32% with TSC
Regulatory contributions	0.24%	Sales	✓	
Mining Retirement Fund	0.50%	Taxable income	✓	Presented as part of the PTU
PTU	8%	Taxable income – tax losses	✓	
Asset depreciation – income tax		✓		Entire investment is depreciated over 5 years
Asset depreciation – Royalty and SMT		✓		Entire investment is depreciated over 10 years

Source: Ministry of Economy and Finance.

Table 6. Fiscal Regimes Modeled in the FARI Analysis

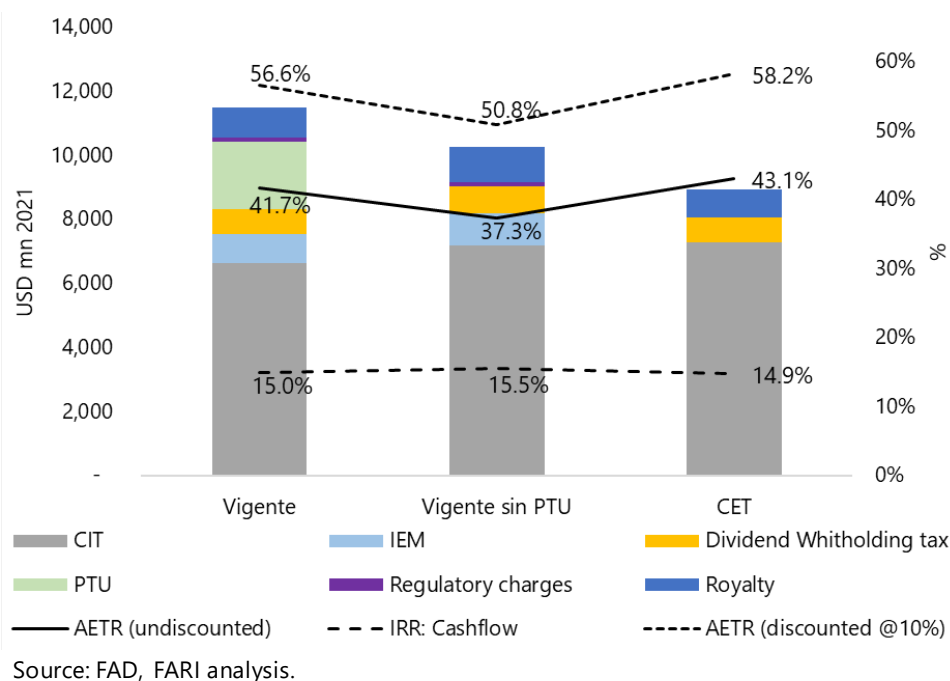
	Current	Current without PTU	TSC
Income tax	29.5%	29.5%	32.0%
PTU	8.5%	0	8.5%
Depreciation		Straight line over 5 years	
Royalty	✓	✓	✗
SMT	✓	✓	✗
SML	✗	✗	✓

Source: FAD, FARI analysis.

D. FARI Analysis of the Mining Fiscal Regime in Peru

26. **The analysis applies different fiscal regimes to the same investment project to highlight the differences in the fiscal parameters on a comparable basis.** The average undiscounted tax burden (AETR) of the current regime in Peru is 41.7 percent (Figure 6). The PTU generates 4.4 percentage points of the tax burden. The tax burden for a project with a TSC is 1.4 percentage points higher than the current one. Discounted AETRs (at 10 percent) have a similar behavior since the cashflow profile is similar. The main source of collection is income tax (between 60 and 70 percent of the total), followed by the Royalty and SMT (15 to 21 percent) and the PTU (18 percent). Lastly, the investor after-tax internal rate of return (IRR) is around 15 percent.

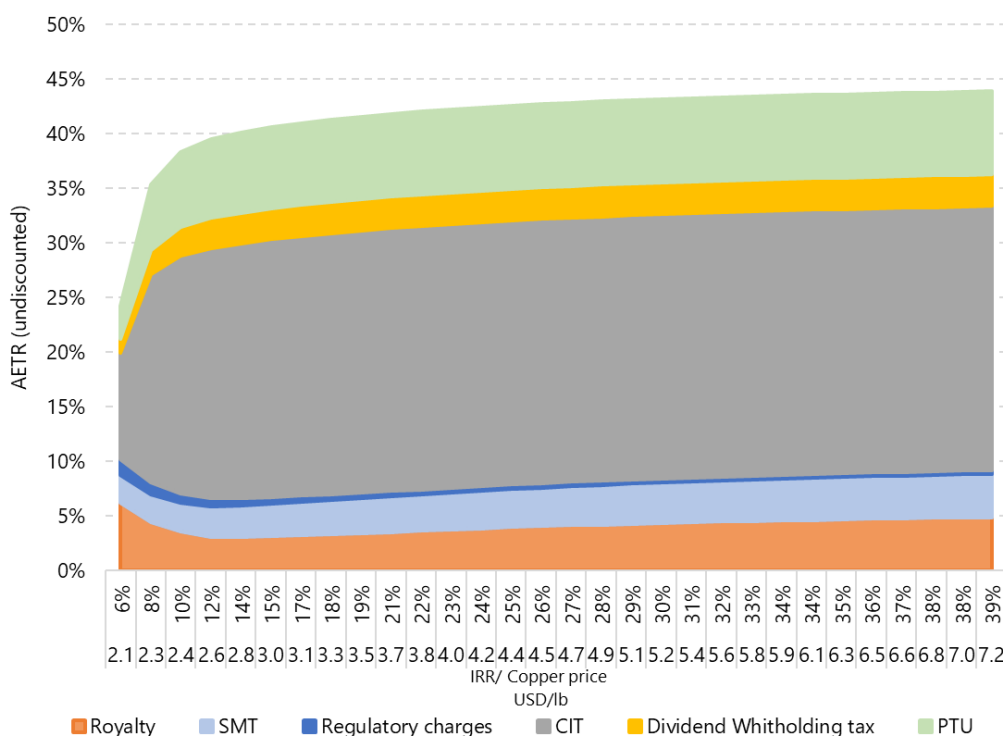
Figure 6. Collection, Government Participation, and Rates of Return on Investment
(In millions of real U.S. dollars (2021), %, large-scale copper project)



27. **To illustrate the effect of the uncertainty surrounding prices, production volume, and costs, an analysis is performed of the collection level and composition in various project profitability scenarios.** A well-designed fiscal regime is automatically adapted to changes in project profitability, with a lower tax burden as the return on investment deteriorates, and vice versa. A fiscal system with these characteristics is referred to as progressive. A progressive regime provides the government and investors with certainty. The various fiscal instruments respond differently to changes in project profitability; generally speaking, profit-based instruments are more adaptable than those based on production value. To analyze the impact on the tax burden of the various levels of profitability for the same project, the AETR is calculated at different profitability levels with varying prices, production, or costs.

28. **Peru's fiscal regime shows a good degree of progressivity, with the tax burden in the general regime stabilized at around 43 percent.** In Figure 7, the regressive nature of the minimum level of the Royalty (equivalent to 1 percent of the sales value) and of regulatory contributions is shown. As profitability increases, so does the operating margin, dominating the progressive effect of the Royalty and SMT. The tax burden increases from around 25 percent for a copper price of US\$2.10/lb (IRR of 6 percent) to 44 percent for a price of US\$7.20/lb (IRR of 39 percent). If the PTU is eliminated, the regime's progressivity is not substantially affected.

Figure 7. Changes in the Tax Burden Due to Variations in Project Profitability
(Current regime, large-scale copper project)



Source: FAD, FARI analysis.

E. Comparative FARI Analysis of Mining Fiscal Regimes in Peru and Other Mining Countries

29. **It is important to understand how the fiscal regime compares to other mining countries that can compete with Peru for mining investment.** To compare fiscal regimes between countries, the FARI analysis is replicated for the same investment project and price assumptions, applying the fiscal regime of each country. In other words, the analysis compares different fiscal regimes in the hypothetical case that they apply to the same representative mining project for Peru, without adjusting for the differences that can exist in the cost structure, mine productivity, or country risk perception, among other variables. A group of countries with a substantial production of copper were selected for the comparison, with Latin American countries being favored (Table 7).

Table 7. Copper Producing Countries in the Comparative Group
(In thousands of metric tons)

	Position	Production (2018)	Production (2019)	Reserves (2020)
Chile	1	5,832	5,787	181,437
Peru	2	2,437	2,455	83,461
China	3	1,507	1,601	23,587
DRC	4	1,225	1,433	17,237
United States	5	1,216	1,285	43,545
Australia	6	913	938	79,832
Russia	7	773	773	55,338
Mexico	8	751	770	48,081
Zambia	9	857	759	19,051
Canada	11	543	573	8,165
Indonesia	13	651	400	
Brazil	14	377	362	
Mongolia	16	320	306	
Panama	18	-	147	

Note: The position is based on 2019 production. The rest of the world's production is 1,180 metric tons. Gray highlighting indicates that no information is available.

Production source:

<https://www.cochilco.cl/Lists/Anuario/Attachments/23/AE2019WEB.pdf>.

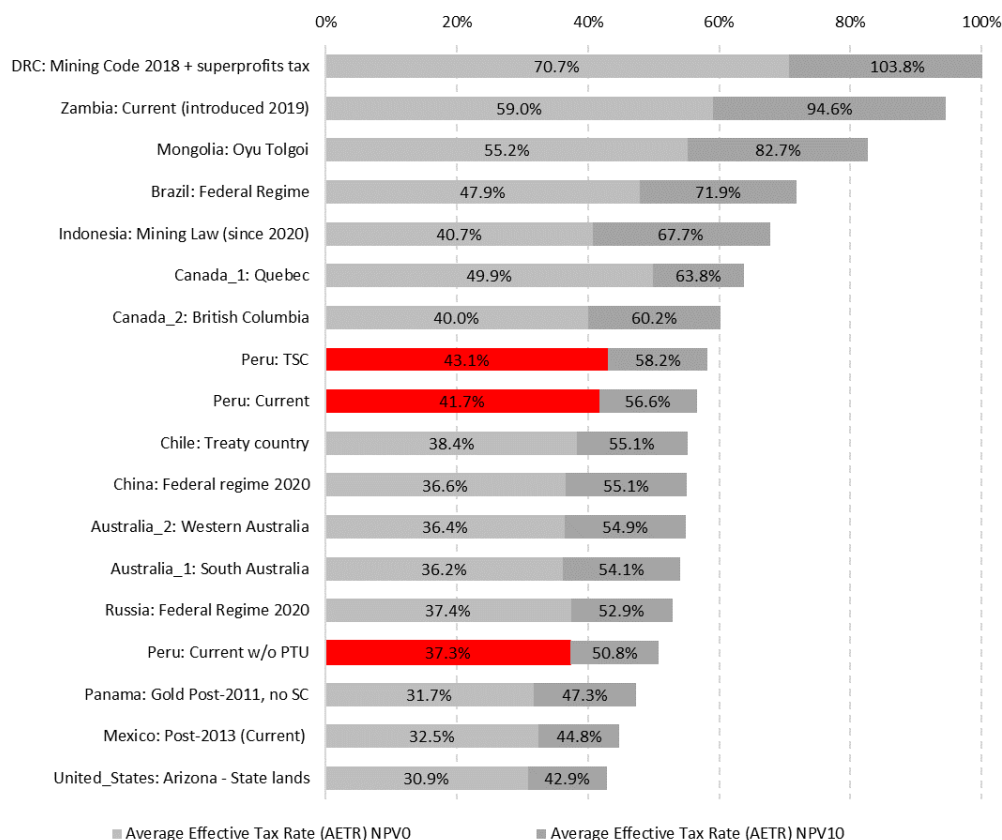
Reserve source: <https://pubs.usgs.gov/periodicals/mcs2021/mcs2021-copper.pdf>.

30. **The tax burden of a representative investment project in Peru, measured as the AETR discounted to present value, is in the middle position of the peer group.** The rate is 56.6 percent (without TSC) and ranks 8th among the 16 regimes listed in Figure 8 (not counting the TSC regime in Peru). Undiscounted, this rate is 41.7 percent and increases to 43.1 percent if the company opts to sign a TSC, that is, 5 percentage points less than the regime in the next step up in the table (Brazil). The United States (Arizona) and Panama have lower tax burdens, slightly above 30 percent, undiscounted. It should also be noted that the tax burden of the current (discounted) regime in Peru is slightly higher than that of Chile, likely the closest competitor for attracting investment in new mining projects. Without considering the PTU, Peru's AETR would be in the lower third of the sample.³

³ Only Mexico has a similar PTU system. The tax burden this represents is included in the calculations for Mexico.

Figure 8. Average Effective Tax Rate: Peru and Other Countries

Undiscounted AETR (gray column, red for Peru) and AETR discounted at 10 percent (dark gray)

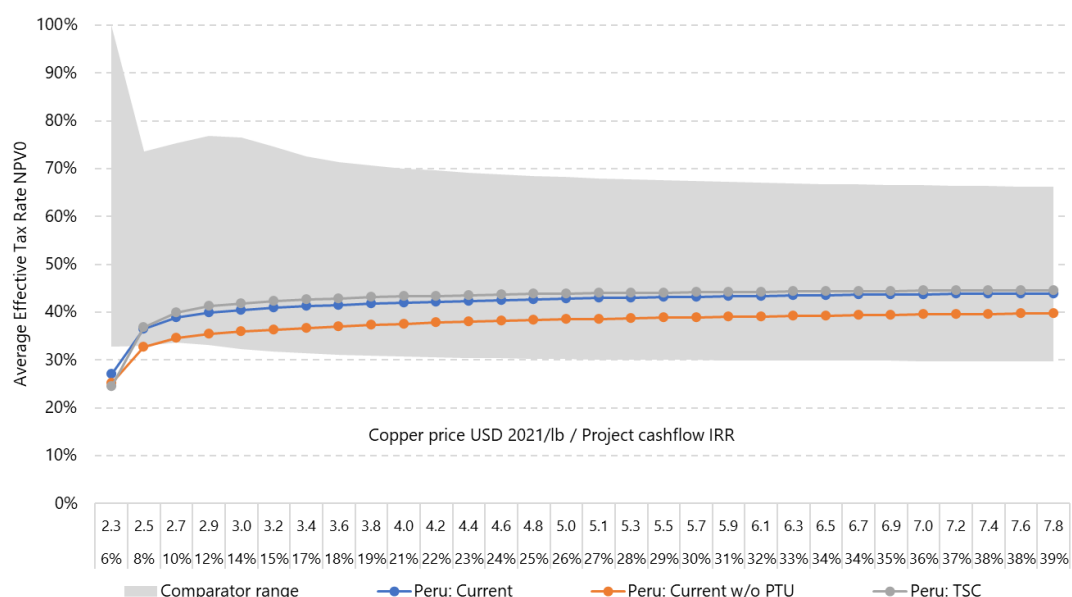


Source: FAD, FARI analysis.

Note: The regimes are listed according to the AETR discounted at 10 percent.

31. **Peru's fiscal regime is one of the most progressive in the group of peers, meaning that the AETR increases more as a project becomes more profitable.** Figure 9 shows that the current regime, even considering the PTU, has the lowest AETR at low profitability. Regimes based on royalties according to gross income, or that have limits on deductions or on amortizable cumulative losses for income tax purposes, are regressive at low levels and moderately profitable. One of the few progressive mining regimes is the one in Chile, which has a similar structure to Peru's, with taxes with progressive rates on operating profit. This regime progressivity is one of the important elements for maintaining Peru's competitiveness as a destination for mining investment.

Figure 9. Changes in the Undiscounted Tax Burden with Varying Project Profitability
(Undiscounted AETR (%))



Source: FAD, FARI analysis.

32. **In summary, the current fiscal regime for mining in Peru is competitive, as the tax burden is in the mid-range of other mining countries and is one of the most progressive.** It is important for reform efforts to maintain these two elements in order to keep Peru as an attractive destination for new mining investment. If the decision is made to increase the tax burden, it is recommended that this increase be moderate, ensuring not to alter Peru's relative position. It is important to remember that the tax burden estimation is very sensitive to the incidence of PTU, which is why it is recommended that this be taken into account when considering the space available for modifications in the tax burden. However, Peru's competitiveness as a destination for mining investment depends on a multitude of variables, and this report analyzes only the fiscal regime. Moreover, the tax burden in Peru is currently higher than it is in Chile, the world's top copper producer.⁴ The possible modifications to the regime should be limited to parametric changes within the progressive structure of the current Royalty and SMT. There is also room for simplifying the Royalty and SMT structure by, for example, decreasing the number of rungs to determine rates.

⁴ An investor in Chile who is a resident of a country without a treaty to avoid double taxation would face a higher tax burden due to the loss of the possibility to credit the corporate income tax against the dividend withholding rate of 35 percent. In practice, however, nearly all large international investors, including those in the mining sector, make their investment to operate in Chile in a way that enables them to reap the benefits of the treaties.

F. Alternatives to Modifying the Mining Fiscal Regime Under Consideration by the Peruvian Government

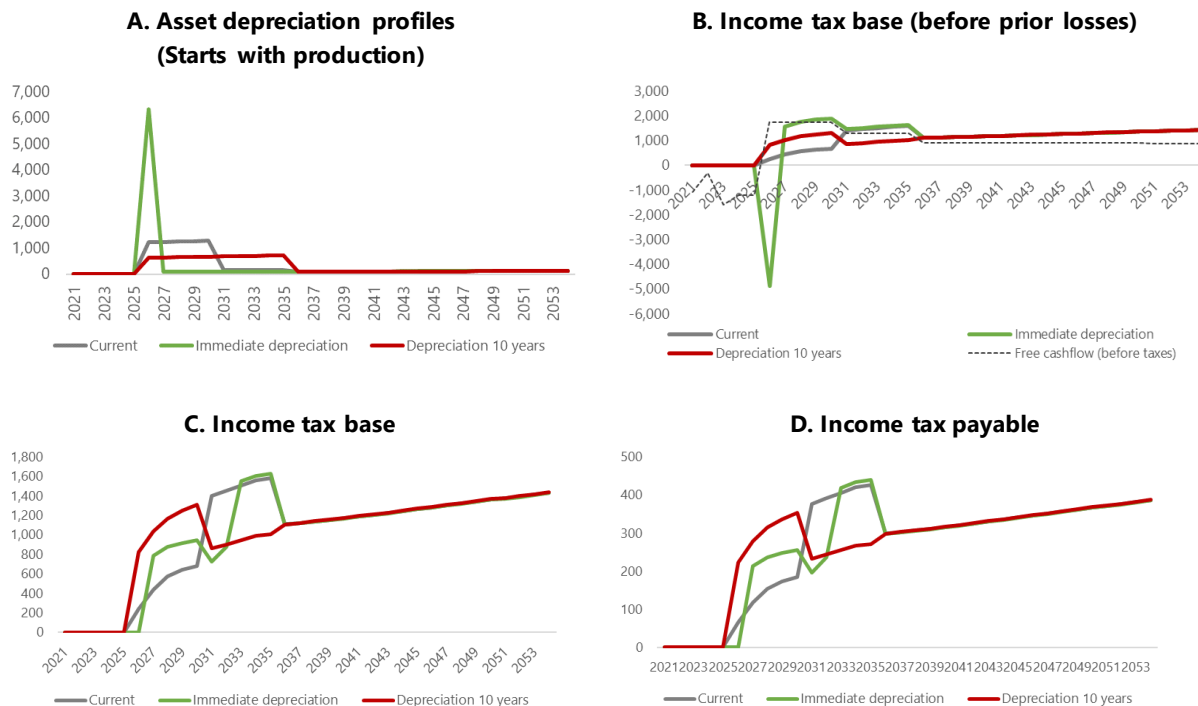
33. **One of the premises expressed by the authorities to modify the fiscal regime in Peru is to maintain the basic structure of the current regime.** In that regard, the report analyzes the effect on collection and return on investment of some of the reform options being considered by the MEF. Only the current and current without PTU scenarios are analyzed, since the TSC scenario would not apply to a new mining investment project.

Option 1: Modification of Asset Depreciation Rates for Income Tax Deduction

34. **Depreciation rates only modify the income tax payment profile over time, not the total amount.** To illustrate the magnitude of the modification of depreciation rates, a comparison is drawn of the depreciation paths, income tax base, and income tax collection for various projects under three assumptions: (i) the investment depreciates over five years (current regime, gray line); (ii) the investment depreciates over 10 years (MEF proposal, red line); and (iii) solely as an extreme case for illustration purposes, the investment depreciates immediately (green line). Mining projects are characterized by the fact that they require a large investment before production starts (Figure 10, panel A); the depreciation rates determine how this amount is reduced from the income tax base over time, in effect smoothing the amount to be depreciated (panel B). In Peru, consideration should also be given to the fact that the indefinite carryforward of tax losses from previous years is only allowed up to a 50 percent reduction in taxable income,⁵ which reduces the effect when the depreciation rates generate tax losses (panel C).

⁵ There is an alternative regime in Peru that allows for the carryforward of 100 percent of losses, but only for four fiscal years.

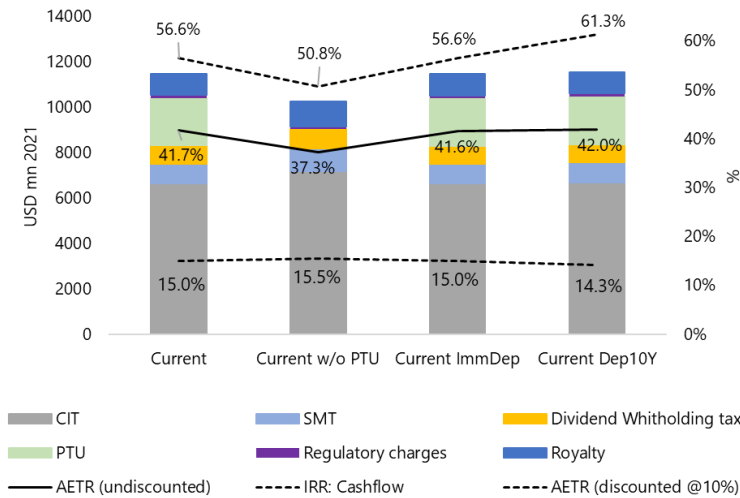
Figure 10. Asset Depreciation Profiles, Income Tax Base, and Income Tax Collection
(In millions of current U.S. dollars)



Source: FAD, FARI analysis.

35. **Modifying the depreciation rates does not change the undiscounted average tax burden.** When the depreciation rates are modified, the amounts collected and the AETRs are marginally modified by the effect on the real value of flows. However, the discounted AETR (with a rate of 10 percent) is modified significantly, reflecting the change in the flow profile. Shifting from an investment depreciation over 5 years in the FARI model to one over 10 years moves collection forward (at the cost of lower future collection) and raises the discounted AETR from 56.6 to 61.3 percent. Reflecting this same effect, the contractor's IRR drops from 15 to 14.3 percent (Figure 11).

Figure 11. Collection, Government Participation, and Rates of Return on Investment
(In millions of real U.S. dollars (2021), %)



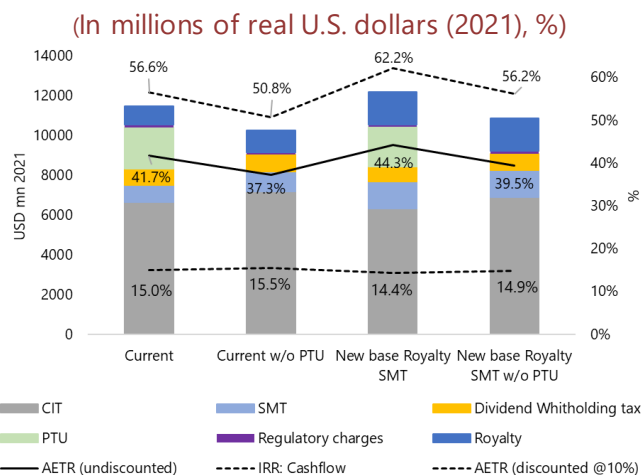
Source: FAD, FARI analysis.

36. **Although it seems intuitive to align the rates of depreciation for mining with those of the general regime, this does not take into account the investment risk profile.** In any case, the benefits for collection seem limited and are only temporary. Modifying depreciation rates only changes the income tax flow profile. Therefore, only the value over time of the said flows is modified. The measure would only have significant effects on projects that accumulate significant investment amounts (new projects, projects to start production, or projects that have recently started production). Most of the projects underway will have relatively non-substantial investments and will be largely unaffected (with the exception of expansions, successful exploration, etc.). The new rates would also not apply to stabilized projects. On the contrary, the risk of affected projects can increase, as the return on investment is delayed.

Option 2: New Royalty and SMT Bases

37. **Neither the PTU payment nor depreciation and amortization could be deducted from the Royalty and SMT base, moving the base of these taxes away from the operating profit concept and significantly increasing the tax burden.** Depreciation expenses are a major determinant of project profitability, which is why excluding them would cause quasi-rent, and not economic rent, to be taxed. Moreover, not only would the base be altered, but the same project would also reach higher operating margin levels more quickly and would therefore face higher rates. The effect on the undiscounted tax burden would be an increase of 2.7 percentage points, or slightly less without the PTU (Figure 12). The investor IRR would decrease 0.6 percentage points in both cases (from 15 to 14.4 percent with the PTU and from 15.5 to 14.9 percent without the PTU). The increase in the discounted AETR is significantly higher, around 5.5 percentage points.

Figure 12. Effect on the Tax Burden and Return on Investment Following a Change in the Royalty and SMT Base

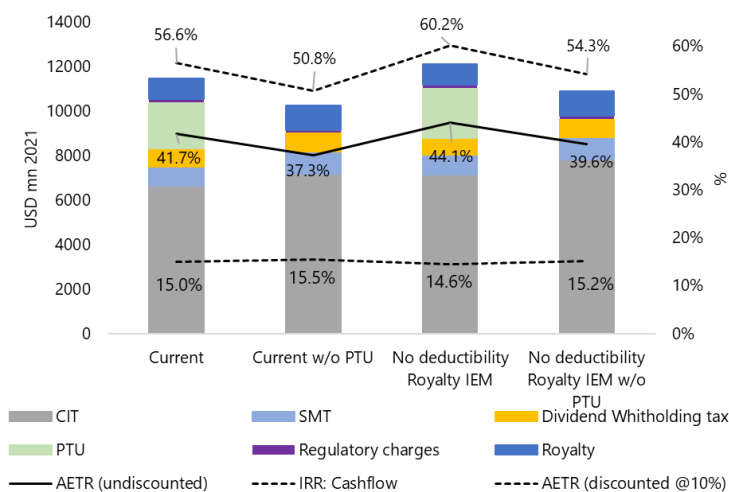


Source: FAD, FARI analysis.

Option 3: Elimination of Royalty and SMT Deductibility from the Income Tax Base

38. **The deductibility of the Royalty and SMT payment would be eliminated from the income tax base.** Specific taxes are a necessary expense for mineral extraction, and it is therefore appropriate for them to be deductible so that the correct income tax base can be obtained. This is why the deductibility of specific mining taxes from the income tax base is a virtually universal practice in mining countries. Of the countries in the sample, only Zambia does not permit mining taxes to be deducted from income tax. This measure is equivalent to raising the Royalty and SMT rates by 29.5 percent (the income tax rate), leading to a significant increase in the tax burden of around 2.5 percentage points (Figure 13).

Figure 13. Effects of Not Permitting a Royalty and SMT Deduction from the Income Tax Base

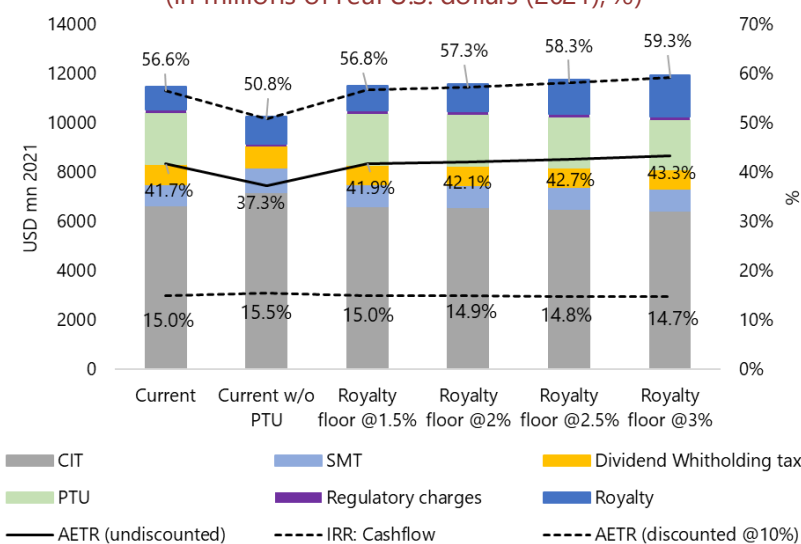


Source: FAD, FARI analysis.

Option 4: Increased Royalty Floor

39. **The proposal consists in increasing the Royalty floor, which is currently 1 percent of the value of sales.** This makes the Royalty a hybrid instrument that combines a progressive structure with a floor that guarantees minimum collection at low operating margin levels. The Royalty floor allows for collection from the start of production and can also improve control, as the base is less susceptible to tax planning. The measure has a non-linear effect on the tax burden (Figure 14): as the Royalty floor increases, the application of progressive tranches of the Royalty based on operating profit becomes less frequent. An increase in the Royalty above 0.5 to 1 percentage point would cause the floor to dominate the behavior of the Royalty, decreasing its progressivity, one of the most attractive features of the fiscal regime (Figure 14). The floor is a regressive element in itself; as the other fiscal elements offset this effect, the system will continue to be progressive as a whole.

Figure 14. Effects of Raising the Royalty Floor
(In millions of real U.S. dollars (2021), %)



Source: FAD, FARI analysis.

40. **As a complementary measure, the MEF is exploring the option of raising the Royalty floor for only larger companies (by production volume or sales amount).** Box 2 shows that for operating margin levels below 36.5 percent, the Royalty floor will always apply. To determine the effect of limiting the increase in the floor to a subset of companies, the MEF must analyze the type of companies that have historically reached these operating margin levels. Insofar as smaller producers have smaller margins, exempting them from the Royalty floor can distort the nature of the floor, as it would only apply to a few producers in the middle tranches of the operating margin. The interaction of the Royalty floor and an exemption could cause jumps in collection from one year to another for the same producer. It would also add more complexity to the fiscal regime.

Box 2. To What Operating Margin Levels Does the Royalty Floor Apply?

It is possible to determine to what operating margin levels the Royalty floor will apply, regardless of income level, operating profit, costs, or any other variable.

- The Royalty (RM) is calculated by applying the effective rate (TE) to the operating profit (UO), $RM = UO * TE$.
- The formula for the effective rate is determined based on the operating margin level in each tranche and the corresponding marginal rate. The formula is as follows:

$$TE = \frac{\sum_{j=1}^{n-1} (Ls - Li)_j * Tmg_j + (MgO - Li)_n * Tmg_n}{MgO}$$

Where L and TMg corresponds to each tranche and marginal rate according to the values in Figure 5. Using the formula for the operating margin, the formula for the Royalty can be expressed based on income:

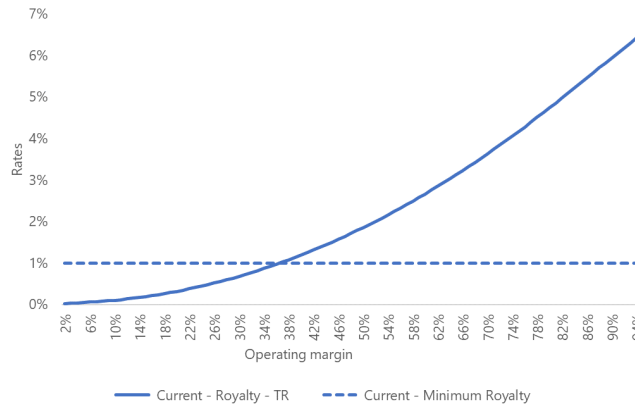
$$RM = I \times \left[\sum_{j=1}^{n-1} (Ls - Li)_j * Tmg_j + (MgO - Li)_n * Tmg_n \right]$$

$$RM = I \times T_R$$

where $T_R = \left[\sum_{j=1}^{n-1} (Ls - Li)_j * Tmg_j + (MgO - Li)_n * Tmg_n \right]$. In this expression, if T_{PISO} denotes the rate of the Royalty floor, which applies to gross income, the Royalty floor will apply when $T_{PISO} > T_R$.

For the current Royalty structure, the minimum Royalty level of 1 percent applies when the operating margin is below 37 percent, as shown in the following chart.

Application of the Royalty Floor to Various Operating Margin Levels



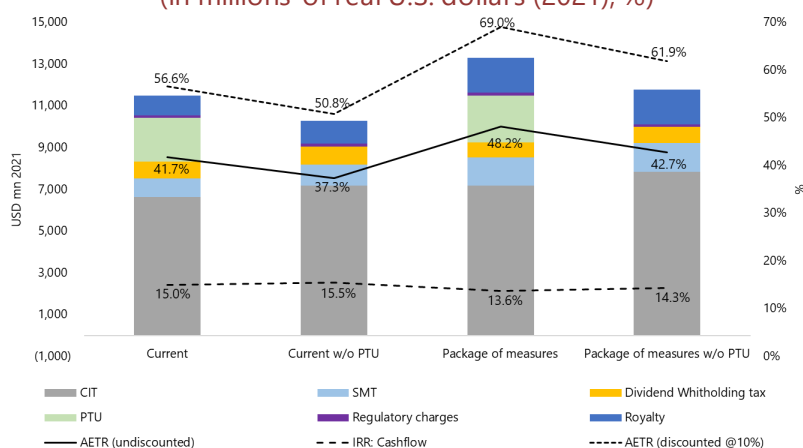
Option 5: Package of Measures

41. **This assumes that all the measures from options 2 to 4 are grouped together.** The assumption is that the fiscal regime is modified by excluding the PTU as well as depreciation and amortization from the Royalty and SMT base, eliminating Royalty and SMT deductibility from the income tax base, and raising the Royalty collection floor to 2 percent. The structure of the rates and tranches of the operating margin for determining the Royalty and SMT are not modified in this scenario. As would be expected from the analysis of options 2 to 4, the tax burden would increase

significantly, by 6.5 percentage points including the PTU (12.4 percentage points in the discounted AETR) and by 5.4 percentage points not including the PTU (Figure 15). The investor rate of return would decrease by 1.4 percentage points.

Figure 15. Effects of the Package of Measures

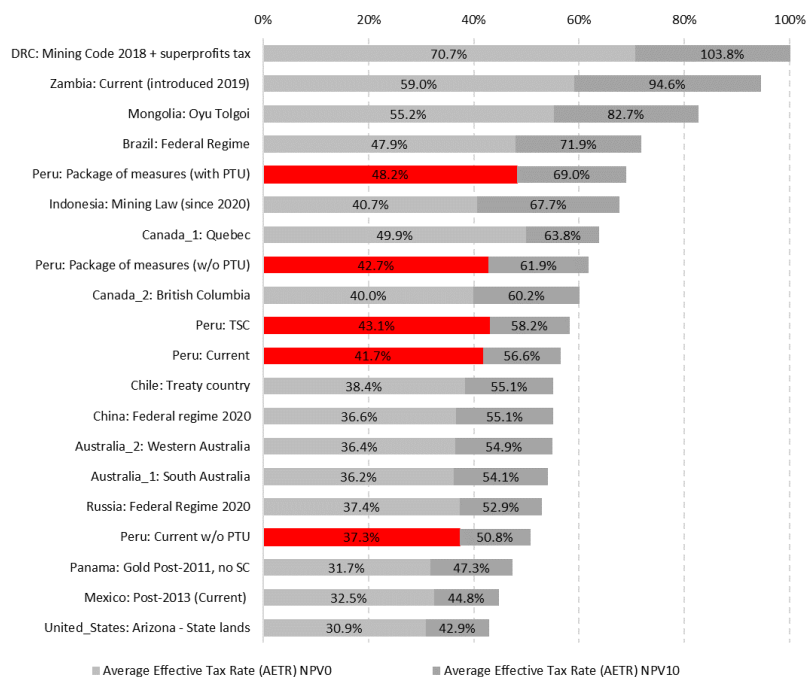
(In millions of real U.S. dollars (2021), %)



Source: FAD, FARI analysis.

42. **The application of all the measures together would impact Peru's competitiveness as a destination for mining investment.** The increase in the tax burden would put Peru in the upper third of the group of peers (Figure 16), surpassing the (undiscounted) tax burden in Brazil.

Figure 16. Average Effective Tax Rate: Peru and Other Countries, Different Regimes
Undiscounted AETR (gray column, red for Peru) and AETR discounted at 10 percent (dark gray)

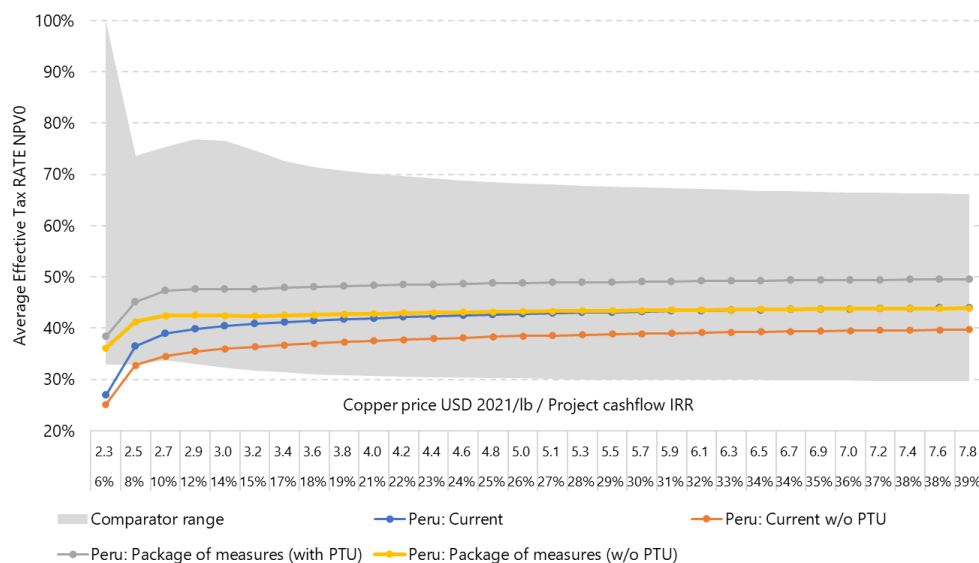


Source: FAD, FARI analysis.

Note: The regimes are grouped according to the AETR discounted at 10 percent.

43. **Applying all of the measures would also have a negative effect on the progressivity of the fiscal regime.** The first effect is that, at low profitability levels, Peru would no longer have the lowest rates of the countries in the sample. Furthermore, at lower profitability levels, progressivity decreases and the system is flatter (Figure 17). This is likely due to the change in the Royalty and SMT base since, by not allowing the deduction for the PTU and depreciation and amortization, the real profitability of projects is taxed in less of a refined way.

Figure 17. Changes in the Undiscounted Tax Burden with Varying Project Profitability
(Undiscounted AETR (%))



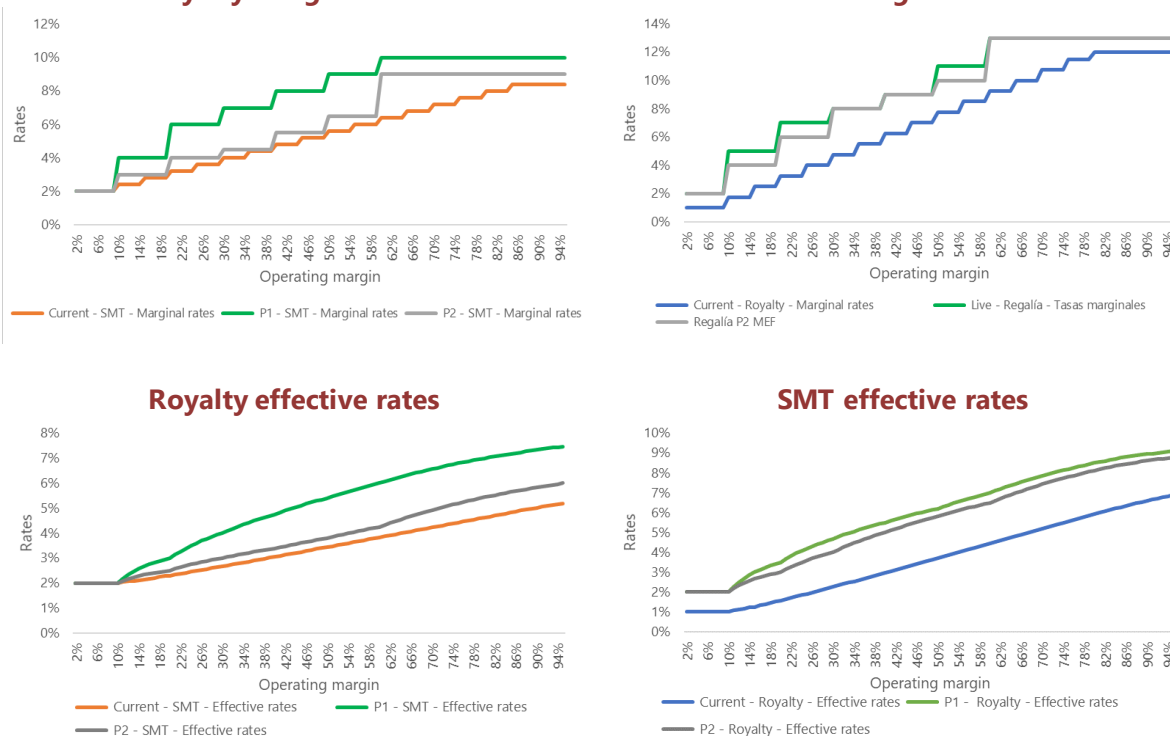
Source: FAD, FARI analysis.

44. **In summary, the complete package of measures affects two of the main positive features of the current fiscal regime for mining in Peru.** On the one hand, it raises the tax burden, putting Peru in the top third of the comparison group. On the other hand, it reduces the system's progressivity.

Option 6: Changes to Royalty and SMT Parameters

45. **Maintaining the rest of the fiscal structure, an analysis is conducted of a scenario that involves modifying the Royalty and SMT rates and tranches, with a higher Royalty floor.** The base of both taxes would be maintained without changes, and the Royalty floor would be raised to 2 percent. As a general modification, consideration is being given to raising the dividend withholding rate from 5 percent to 7.5 or 10 percent. For each increase in the dividend withholding rate, a parameter-setting option is presented for the Royalty and SMT, calibrated to maintain the competitiveness of the fiscal regime in Peru (the P1 scenario corresponds to a rate of 7.5 percent, whereas the P2 scenario corresponds to 10 percent). These parameters are shown in Figure 18.

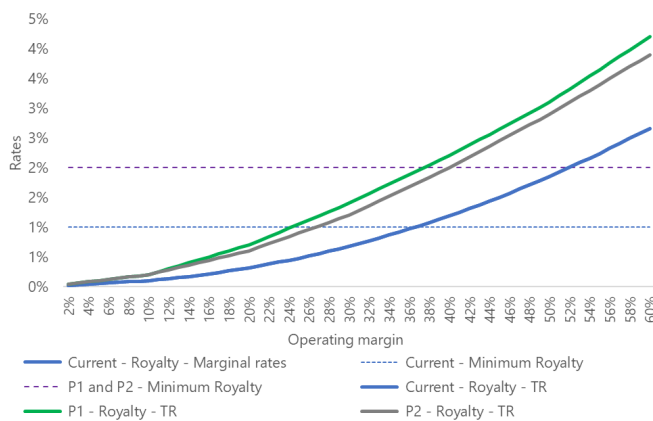
Figure 18. Marginal and Effective Rates of the New Royalty and SMT Parameter-Setting



Source: FAD mission.

46. **A second criterion for setting Royalty and SMT parameters was to not substantially modify the operating margin from which the new Royalty floor (2 percent) applies.** As shown in Figure 19, in the P1 scenario, the 2-percent Royalty floor would apply to operating margins below 37 percent. In the P2 scenario, this value is 39 percent. As a reference, this parameter is currently 36.5 percent.

Figure 19. Application of the Royalty Floor to Various Operating Margin Levels

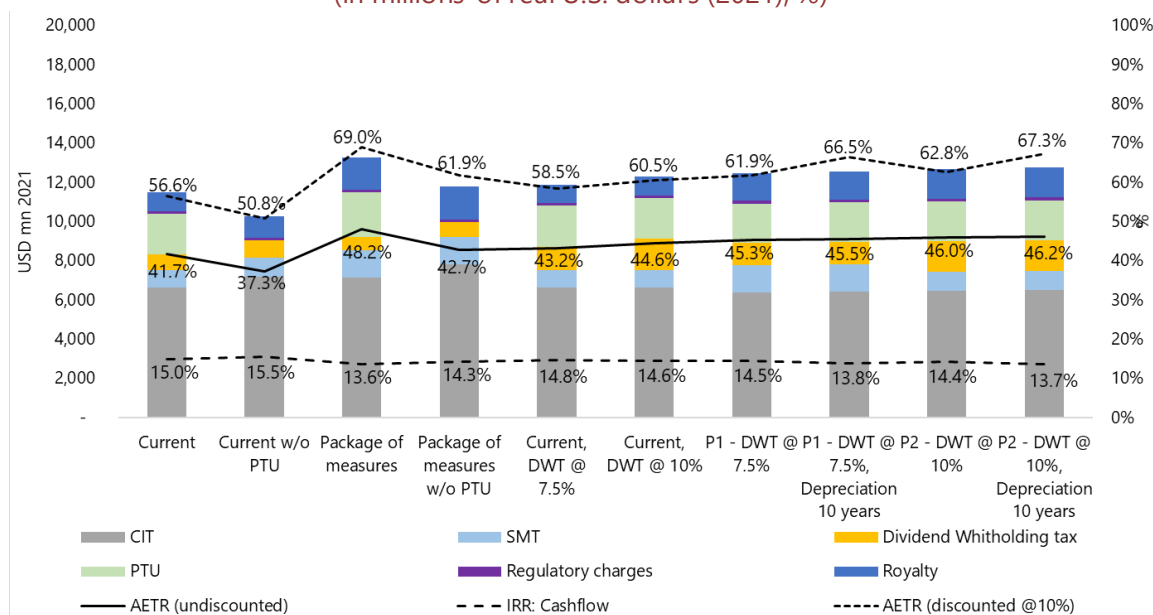


Source: Own FAD mission compilation.

47. **Modifying the Royalty and SMT tranches and rates makes it possible to scale the modifications to the parameters to maintain the fiscal regime's competitive position in Peru.**

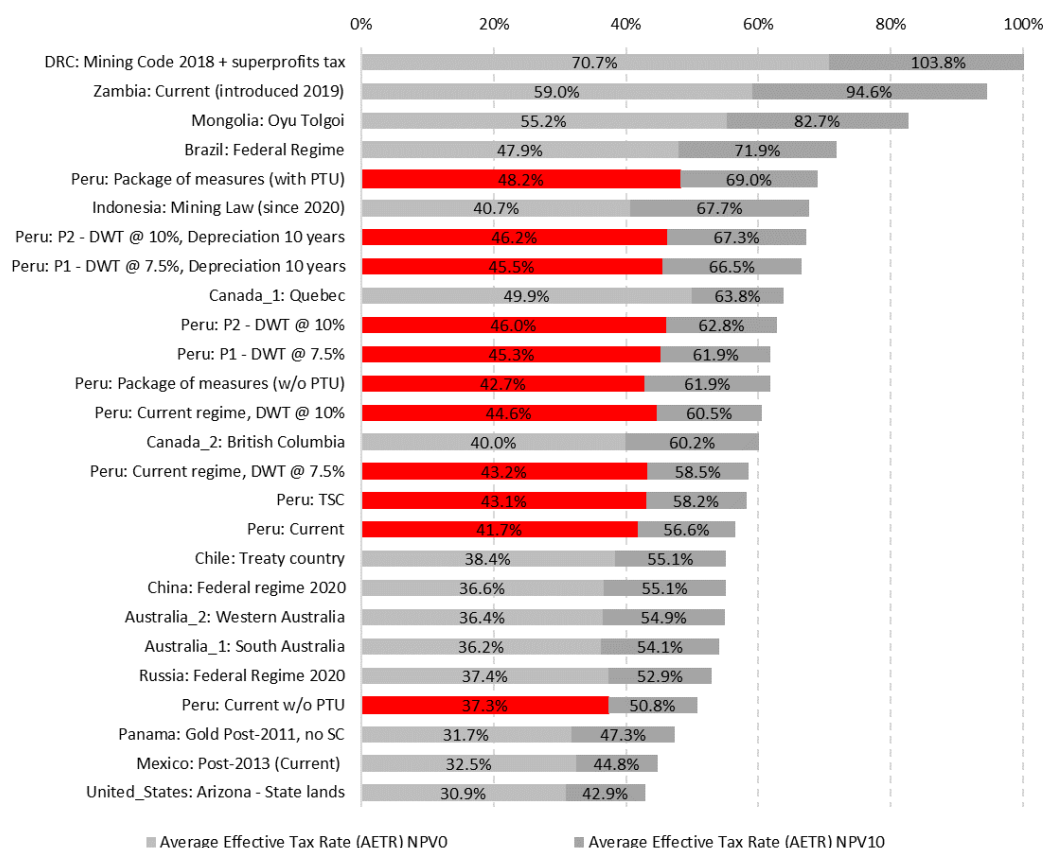
On its own, the increase in the dividend withholding rate to 7.5 and 10 percent raises the tax burden by 1.5 and 2.9 percentage points, respectively. Reflecting this increase in the tax burden, the parameter-setting previously suggested for the Royalty and SMT would bring the (undiscounted) tax burden to 45.5 and 46.2 percent. The investor return would be maintained at fairly attractive levels (Figure 20). Moreover, this increase in the tax burden would keep Peru in the mid-range of other mining countries, since its relative position would not be modified (Figure 21).

Figure 20. Effects of Changing the Royalty and SMT Parameters under Different Scenarios
(In millions of real U.S. dollars (2021), %)



Source: FAD, FARI analysis.

Figure 21. Average Effective Tax Rate: Peru and Other Countries, Different Regimes
Undiscounted AETR (gray column, red for Peru) and AETR discounted at 10 percent (dark gray)

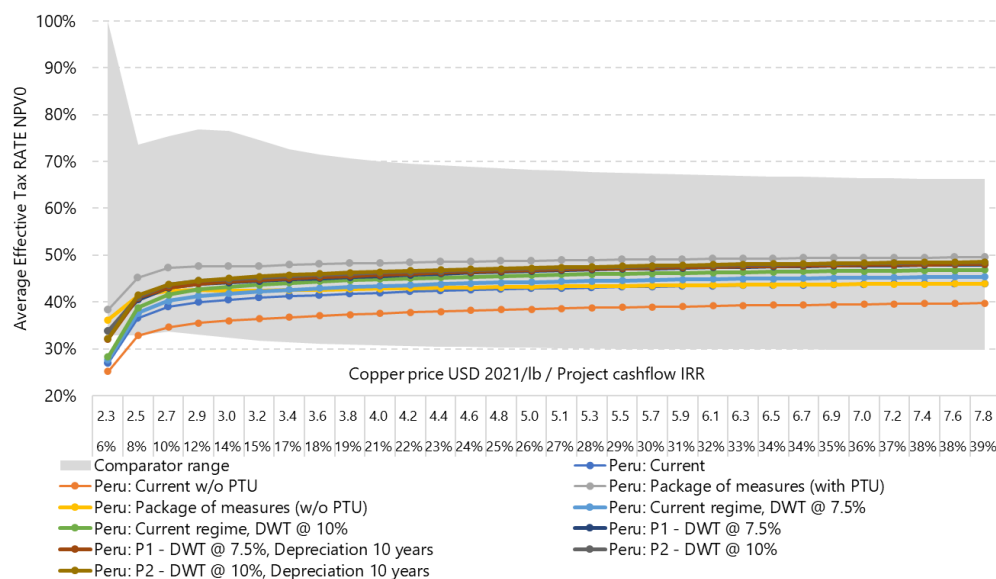


Source: FAD, FARI analysis.

Note: The regimes are grouped according to the AETR discounted at 10 percent.

48. **Modifying the Royalty and SMT parameters, together with the increase in the dividend withholding rate, would slightly increase their progressivity.** This regime would have a more marked progressivity at lower profitability levels, as shown in Figure 22. In addition, it continues to maintain high progressivity at increasing profitability levels, significantly higher than in the option in which all the other measures under consideration are adopted.

Figure 22. Changes in the AETR with Varying Project Profitability
(operating margin, price of copper, and IRR)



Source: FARI model, FAD.

Recommendations

- Modifying the Royalty and SMT base is not considered appropriate.
- The changes to the fiscal regime should be limited to the Royalty and SMT parameters, taking into account the increase in the tax burden due to a higher dividend withholding rate that is under consideration.
- As part of setting new Royalty and SMT parameters, consideration could be given to reducing the number of tranches in the operating margin for the calculation of the effective rates. This report includes parameter-setting that could serve as a starting point.
- The benefits of equating the mining depreciation rates to the general regime must be weighed against the increased risk to investors.
- In any scenario, the recommendation is to maintain the immediate depreciation of exploration expenses.
- The increase in the Royalty floor should also be limited to a maximum of 1 percentage point.

G. Other Tax Aspects Applicable to Mining in Peru

Ring-Fencing Applicable to the Royalty and SMT

49. **Ring-fencing defines the scope that a mining company has in order to consolidate income and expenses so as to calculate mining taxes.** Normally, for income tax, a taxpayer's income and deductions are calculated on a consolidated basis: a loss in one activity is deducted from income from the taxpayer's other activities. In extractive industries, however, this can significantly delay government collection since the holder of a mining right can deduct exploration expenses incurred in a new project from income derived from an established project. Consolidation can also act as a barrier for new participants because they have no current income from which to deduct exploration expenses. Lastly, consolidation can distort the measure of a mining project's profitability.

50. **To avoid these issues, mining operations can be "delimited" with the aim of determining mining taxes.** Ring-fencing can be introduced with an increasing level of constraint: (i) at the sector level, so that a company cannot consolidate mining and non-mining activities; (ii) at the concession area level (attractive because the tax treatment aligns with the mining regulatory treatment); or (iii) at the individual project level (see Box 3). The drawback of tight ring-fencing is that it can discourage investment, especially in exploration. Some countries, such as Canada, relax ring-fencing to allow the deduction of failed exploration expenses from the base of a successful project.

51. **In Peru, the Royalty and SMT are calculated company wide, not by mining project, with the exception of projects developed under a TSC.** Mining taxpayers can consolidate their economic mining activities at the corporate level for the purposes of both the income tax and the Royalty and SMT. A special case is that of mining units with a TSC, which require individual treatment because the fiscal parameters applied to them differ from those of the rest of projects.

Recommendation

- Apply ring-fencing at the project level for the Royalty and SMT, allowing unsuccessful exploration expenses to be deducted from the base of successful projects.

Tax Stability Agreements

52. **Peru offers mining companies a tax stability arrangement, which carries a cost because it imposes a higher income tax rate and is less generous than what is available to taxpayers outside the mining sector.** Tax stability is a means of offsetting the country risk perceived by mining companies with long-term projects and large investments. The degree of tax stability that a country offers must be calculated considering the country and institutional risk perceived by investors. In Peru, tax stability is granted by freezing the application of the tax provisions in effect at the time of signing of the agreement. This arrangement has the advantage of being symmetrical, meaning that companies are not affected by increases in fiscal parameters, but they also do not

benefit from decreases. Tax stability also carries a cost for the investor, given the slightly higher income tax rate (2 percentage points higher than the rate in effect at the time of signing). This is good because it essentially serves as insurance for the investor against potential modifications to the fiscal framework in the future.

53. **However, the approach of freezing fiscal provisions can be complicated to administer.**

Fiscal laws may be amended, potentially multiple times, during the tax stability period, which could complicate tax administration since contracts signed at different times will likely be governed by different fiscal laws. One option is to outline all the parameters to be stabilized in the TSC so that all the information necessary for administering the tax burden of the stabilized project is contained in a single document. Another option is to limit the scope of the stability to mining-specific taxes, which should entail the elimination of stabilization contracts for other taxpayers with respect to tax conditions of general application.

Recommendation

- Grant stability only for parameters relating to mining taxes and changes targeting the mining industry, with no protection afforded against fiscal changes of general application.

Determining the Operating Profit for the Royalty and SMT

54. **The taxable base of the Royalty and SMT is calculated by subtracting operating costs and expenses from the income reported by the taxpayer.** Investment in tangible and intangible assets is included in costs in accordance with the accounting standards applied by the company, with the exception of exploration expenses, which are depreciated for tax purposes in a straight line over the expected life of the mine. This means that SUNAT must review and, where applicable, audit two different taxable bases, namely the income tax base and the Royalty and SMT base. Moreover, using accounting standards criteria to calculate the depreciation of assets reflected in costs makes their calculation less transparent. Conversely, the rules for deducting assets to calculate income tax are established in the tax regulations.

Recommendation

- Apply criteria that are to be defined in legislation to asset deduction and amortization for the calculation of the Royalty and SMT base.

H. Fiscal Parameters in Other Mining Countries

55. **The majority of mining fiscal regimes consist of corporate income tax and a mining-specific tax based either on gross income or, like in Peru, on a measure of net profit.**

Within this common fiscal structure, mining fiscal regimes differ in significant respects, not only in the choice of instruments, but also in the structure of the mining taxes, the income tax, and the treatment of different minerals (for example, minerals such as gold and diamonds are sometimes

treated differently). This section describes the main tax components used in mining fiscal regimes for copper in 15 jurisdictions across 13 countries making up the sample of peer countries.

56. **Care should be taken when comparing differences in tax parameters alone.** The competitiveness of the fiscal regime is ultimately determined by the total tax burden faced by a mining project. Consideration must also be given to the interaction between various fiscal instruments (this is precisely the approach of the FARI-based fiscal regime evaluation). For some countries, the modeled fiscal regime is not the tax regime generally applicable to new investments, but rather the fiscal terms applied to a representative project (in Mongolia, for example, the modeled regime is the one applied to the Oyu Tolgoi project).

Corporate Income Tax

57. **Corporate income tax is calculated on taxable income and is charged in all mining countries, generally at the same rate as for other activities.** Most countries apply a fixed rate ranging from 25 to 30 percent (Table 8). Brazil applies the highest rate (34 percent), whereas Indonesia and Russia apply the lowest at 20 percent.

58. **The fiscal treatment of the depreciation and amortization of capital assets is particularly important for extractive industries due to the large initial investments.** The mining models used for the FARI analysis do not disaggregate assets at the same level of detail as fiscal rules. Therefore, the depreciation rate chosen for the FARI analysis is the one closest to the type of assets for each country, including accelerated depreciation where applicable.

59. **There are big differences between countries in how asset deductions are treated.** Most countries depreciate assets using the straight-line method, typically ranging from 5 to 10 years, while others, such as Russia and the Democratic Republic of the Congo, allow for depreciation over 2 years (Table 8). Many countries (Australia, Canada, United States, Russia, and Zambia) permit the immediate deduction of investment in exploration. In most countries, the tax depreciation of assets begins when production commences.

60. **In other mining countries, a longer carryforward of tax losses is permitted for mining given the long payback period that is typical for the sector.** Various countries provide for unlimited loss carryforward periods without an annual cap (like in Peru, 50 percent of profits), such as Australia, Brazil, Chile, the United States, Mongolia, and Russia. Many countries limit loss carryforward periods, but for longer amounts of time for extractive companies compared to ordinary companies—one such country being Canada at 20 years—although this requires efficient administration in order to keep historical tax records. As for determining the tax base, it is an almost universal practice to allow the payment of mining taxes to be deducted from the income tax base, except in Zambia (Table 8).

Table 8. Main Features of Corporate Income Tax in Mining Countries

Country	Tax rate	Depreciation rates	Use of tax losses	Deductibility of mining taxes
Australia				
South Australia	30.0%	Exploration: Immediate Development: SL (10 years)	Unlimited	Yes
Western Australia	30.0%	Exploration: Immediate Development: SL (10 years)	Unlimited	Yes
Brazil	34.0%	Exploration: SL (5 years) Development: SL (5 years)	Unlimited	Yes
Canada				
British Columbia	27.0%	Exploration: Immediate Development: DB (30%)	20 years	Yes
Quebec	26.5%	Exploration: Immediate Development: DB (30%)	20 years	Yes
Chile	27.0%	Exploration: SL (6 years) Development: SL (6 years)	Unlimited	Yes
China	25.0%	Exploration: SL (10 years) Development: SL (10 years)	5 years	Yes
United States	26.0%	Exp. & Dev. (70%): Immediate Exp. & Dev. (30%): SL (5 years)	Unlimited	Yes
DRC	30.0%	Exploration: SL (2 years) Development: SL (2 years)	5 years	Yes
Indonesia	20.0%	Exploration: SL (4 years) Development: SL (4 years)	10 years	Yes
Mexico	30.0%	Exploration: SL (8 years) Development: SL (8 years)	10 years	Yes
Mongolia	25.0%	Exploration: SL (10 years) Development: SL (10 years)	Unlimited	Yes
Russia	20.0%	Exploration: Immediate Development: SL (2 years)	Unlimited	Yes
Zambia	30.0%	Exploration: Immediate	10 years	No

Source: FARI library of fiscal regimes.

Note: SL means straight line, DB means declining balance.

Profit-Based Mining Taxes

61. **Taxes specific to mining based on profits aim to tax windfall profits generated from the extraction of minerals.** Ideally, these instruments should not distort investment and production decisions in connection with a mining project because they are based on a measure of profits. One disadvantage is that they increase tax collection and administration complexity, which is why some countries (for example, Chile and Mexico) align specific-mining tax calculations with income tax returns (Box 3).

Box 3. Mining Taxes Based on Profits in Other Mining Countries

- **Chile:** The Specific Tax on Mining Activities (*Impuesto Específico a la Actividad Minera*) has a structure similar to the Royalty and SMT in Peru. It is applied to Taxable Mining Operating Income (*Renta Imponible Operacional Minera* – RIOM), which is a modified measure of taxable income. It is applied progressively at a rate ranging from 5 to 34.5 percent based on the mining operating margin for projects with production greater than 50,000 metric tons of fine copper equivalent. Ring-fencing is applied at the company level.
- **Canada (British Columbia):** A fixed rate of 13 percent is applied to net income, calculated as the difference between operating and capital income and costs and cumulative negative cash flows uplifted by a prescribed rate of increase. An alternative minimum tax is calculated as 2 percent of the difference between current operating costs and income. Ring-fencing is applied at the mine level.
- **Canada (Quebec):** Net income is taxed at a progressive marginal rate ranging from 16 to 28 percent as the operating margin increases. Net income is similar to taxable income for income tax purposes, but with different depreciation rates. An alternative minimum tax is also calculated at a rate of 1 percent on the value of sales below Can\$80 million and 4 percent on a value above Can\$80 million. The tax is delimited at the mine level.
- **Mexico:** A fixed rate of 7.5 percent is charged on taxable income for income tax purposes, less operating costs and exploration investments. Until 2020, companies could deduct surface payments. Ring-fencing is applied at the company level.
- **Papua New Guinea:** A 30-percent tax is charged on positive cash flows, with a 15-percent adjustment on cumulative negative cash flows. This tax had been eliminated but was recently reintroduced.
- **United States (Arizona):** A tax is applied at a rate of 2.5 percent of net operating profits, calculated as 50 percent of the difference between the gross production value and production costs (generally those incurred in mining and processing up to the point of sale). This includes depreciation and property taxes.

62. **As a general rule, the lowest available withholding rate for a country with which a treaty was signed to avoid double taxation is used for the FARI analysis.** All sample countries have double taxation treaties, and the differences between the resident and non-resident rates can be fairly substantial (Table 9). For example, in Canada, the withholding rate on dividends for non-residents is 25 percent, but under treaties can drop to 5 percent for residents of Australia, Austria, Colombia, France, and Germany and to 10 percent for residents of Chile, China, and Indonesia. To avoid double taxation on cash distributions, some countries (notably Australia and Chile) use an imputation system in which tax credits are granted for the amount of taxes already paid on company profits. For interest tax withholding, some countries permit a lower rate only for transactions with unrelated parties and financial institutions.

63. **In addition to using tax withholding as a way of avoiding excessive deductions, the deductibility of certain expenses is usually limited.** Deductible expenses can be inflated by payments to the parent company outside the country where the mining activity takes place, and financial payments can also be overstated through intra-company financing (either inflating the loan amount or interest rate). The most common safeguards are to limit the deductibility of interest on the income tax base through a cap on the debt-to-capital ratio (with interest payments above this limit being treated as income from dividends) or to limit the deductibility of interest paid to a certain

proportion of income (Table 9). None of these measures are entirely satisfactory since it can be difficult to define the capital base to be used in the first case and to protect against the use of hybrid financial instruments. Furthermore, profits can be very volatile, particularly for companies in the mining sector, meaning that limitations on interest deductions are procyclical.

Table 9. Rules for Limiting the Deductibility of the Payment of Financial Expenses

Country	Debt rule: Capital		Deduction limit	
	Ratio Debt: Capital	Applies to total debt or to debt of related parties?	Limit	Applies to
Australia				
South Australia	1.5:1	Total		
Western Australia	1.5:1	Total		
Brazil	2:1	Both		
Canada				
British Columbia	1.5:1	Related parties		
Quebec	1.5:1	Related parties		
Chile	3:1	Total		
China	2:1	Related parties		
DRC	3:1	Total		
Indonesia	4:1	Total		
Mexico	3:1 ³	Related parties	30%	EBITDA
Mongolia	3:1	Related parties	30%	EBITDA
Russia	3:1			
Zambia			30%	EBITDA

Source: FARI library of fiscal regimes.

64. **All countries for which information is available charge a periodic payment for the concession area, and the amount varies significantly from one country to the next.** Surface payments provide early and stable income for governments and create incentives to prevent the accumulation of concessions for speculative purposes. Establishing a surface payment can be complementary to regulatory requirements for mining concessions to avoid delays in the startup of mining activities. However, they are not generally a significant source of government revenue. In most countries (Brazil, China, Democratic Republic of the Congo, Mexico, and Western Australia), surface payments increase over time, and the rate in Mexico increases further if there is no activity in the mining area (Table 10). The increase in rates over time is usually substantial; for example, it is 22 times in Mexico and 5 times in China. In some countries, the rates are automatically adjusted to inflation (Mexico) or are denominated in dollars (DRC).

Table 10. Concession Area Payments for Mining Activity
(In U.S. dollars per square kilometer)

Country	Exploration license		Production license	
	Minimum	Maximum	Minimum	Maximum
Australia				
South Australia	9.2	15.6	3,894.4	4,694.1
Western Australia	41.4	137.7	1,390.8	1,390.8
Brazil	90.0	135.1		
Canada				
British Columbia	1,507.4	1,507.4	1,507.4	1,507.4
Quebec	1,756.1	3,674.3	1,756.1	3,674.3
China	2.8	14.2	-	-
Chile	147.1	147.1	735.5	735.5
United States	0	200	5% of land value	
DRC	20.0	40.0	40.0	80.0
Indonesia	200.0	200.0	400.0	400.0
Mexico	83.5	1,826.2	83.5	1,826.2
Mongolia	N/A	N/A	N/A	N/A
Panama	N/A	N/A	N/A	N/A
Russia	N/A	N/A	N/A	N/A
Zambia	N/A	N/A	N/A	N/A

Source: Baker McKenzie Global Mining Guide 2020 (<https://globalminingguide.bakermckenzie.com>) and domestic sources.

III. CAPITAL GAINS TAX

A. Introduction

65. **The executive informed Congress of its intention to amend the tax regime applicable to capital gains (Draft Law PL583 of October 27, 2021).** The initiative with which it requests the delegation of powers to legislate on the matter expressly states that it will reform first and second category income tax and income tax on dividends received by domiciled legal persons,⁶ which is third category income (Box 4).

Box 4. Income Subject to Income Tax in Peru (Domiciled Persons) – By Category

First category: Natural persons – rental, sublease, and, in general, temporary transfer of assets.

- Rate: 6.25 percent on net income or 5 percent on gross income

Second category: Natural persons – proceeds from the sale of shares, securities, and real estate, in addition to dividends, interest, royalties, and benefits paid for endowment life insurance, and earnings from derivative financial operations.

- 5 percent on dividends; 6.25 percent on net income or 5 percent on gross income for disposal of securities and real estate
- 4.99 percent on interest

Third category: Legal persons – income from business activity, including all capital gains, except dividends (exempt).

- General rate of 29.5 percent

Fourth category: Independent personal and professional services and managerial activities in companies. A general deduction of 20 percent of gross income is permitted, up to 24 UIT.

Fifth category: Natural persons – dependent employment wages, subject to progressive marginal rates, starting from 7 UIT (ceiling of the income tax-free bracket, also applies to fourth category). Personal deductions as a whole are capped at 3 UIT.

- Marginal rates for fourth and fifth categories: 8 percent (0–5 UIT); 14 percent (5–20 UIT); 17 percent (20–35 UIT); 20 percent (35–45 UIT); 30 percent (45+ UIT).

Foreign source income (without category) – Taxed according to the regime of the recipient, legal person general regime, and natural person at the rate applicable to employment income, except proceeds from the disposal of shares, which are taxed at the second category rate.

66. **The purpose of the initiative is to increase revenue from the taxation of these income categories and improve the system's progressivity.** Capital gains and dividends have a preferential treatment compared to employment income,⁷ despite being earned primarily by

⁶ PL583, Art. 3(a) 1. i-ii.

⁷ According to the income tax rate, a natural person with fifth category income of 60 UIT would pay an average income tax rate of just over 15 percent.

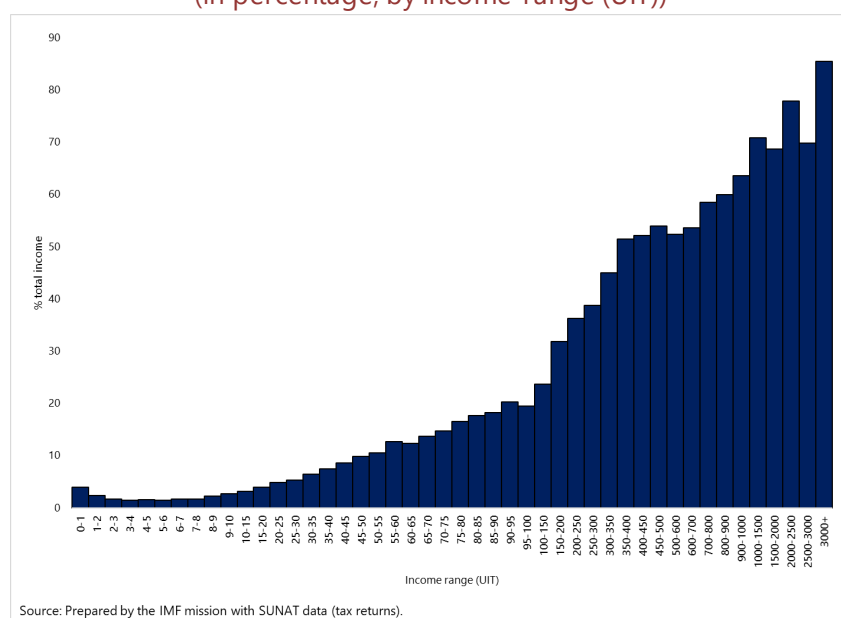
high-income persons.⁸ Less than 1 percent of taxpayers who are natural persons with higher (reported) income above 40 UIT earn close to 75 percent of total first and second category income. Similarly, most high-earner income is capital income, for example, over 50 percent when their income exceeds 350 UIT (Figure 23). Conversely, taxpayers with annual income up to 5 UIT, which account for 66 percent of all taxpayers, earn less than 4 percent of the total reported income in these categories (Table 11), and the capital gains component in their total income is small.

Table 11. Distribution of Capital Income by Income Range, 2020

UIT income range	Persons	% Total	Income (*)	% Total	Cumulative (**)
0-5	4,879,300	66.0	741,360	3.8	100.0
5-10	1,548,907	21.0	843,537	4.3	96.2
10-20	634,963	8.6	1,309,416	6.7	91.9
20-40	274,577	3.7	1,831,585	9.4	85.1
40-80	22,990	0.3	356,823	1.8	75.7
80-150	20,718	0.3	2,022,336	10.4	73.9
150-300	7,466	0.1	2,272,336	11.7	63.5
300-600	2,398	0.0	2,094,920	10.8	51.8
600-1500	918	0.0	2,186,295	11.2	41.0
1500+	356	0.0	5,795,641	29.8	29.8
Total	7,392,593	100.0	19,454,248	100.0	

(*) First and second category income + second category dividends; thousands of soles. (**) In ascending order.
UIT: Unit of taxation = S/. 4,300 (2020).
Source: Prepared by the IMF mission with SUNAT data (tax returns).

Figure 23. Capital Income in Total Income of Natural Persons, 2020
(in percentage, by income range (UIT))



⁸ The rate applicable to capital income is normally 5 percent, considerably lower than the average income tax rate. However, the income tax rate for natural persons exempts the first 7 UIT, which means that two thirds of persons have income tax-free earnings.

67. **First and second category income tax collection is small.** In recent years, collection for both categories have accounted for around 0.4 percent of GDP, contributing 6.4 percent to total income tax revenue in Peru (Table 12). The first percentage has remained stable in recent years, whereas the second has risen mainly due to the decrease in third category income tax collection (business income).⁹ OECD countries that record income tax on capital gains also collect modest amounts in percent of GDP, typically below 1 percent, with the exception of the United States and Sweden (see Annex I, Table A1).¹⁰ Therefore, a significant revenue enhancing reform would have to examine other aspects of Peru's tax system, beyond the treatment of capital gains.¹¹

Table 12. Revenue from Income Tax, by Category

Income category	As a percentage of revenue from income tax					As a percentage of GDP				
	2005–2009	2010–2014	2015–2019	2020	2021 (5)	2005–2009	2010–2014	2015–2019	2020	2021 (5)
First category (1)	1.1	0.7	1.4	1.3	1.1	0.06	0.05	0.08	0.07	0.06
Second category (1)	3.0	3.6	5.0	5.1	7.1	0.19	0.25	0.28	0.27	0.36
Third category (2)	69.0	64.4	53.6	46.3	57.7	4.24	4.41	3.00	2.48	2.90
Fourth category (3)	3.1	2.7	4.1	4.0	3.6	0.18	0.18	0.23	0.21	0.18
Fifth category	17.6	19.5	22.5	24.0	18.7	1.05	1.33	1.26	1.29	0.94
Non-domiciled persons	5.4	8.0	10.1	14.8	7.3	0.32	0.55	0.57	0.79	0.37
Other income (4)	0.8	1.1	3.2	4.3	4.5	0.05	0.08	0.18	0.23	0.23
Total	100.0	100.0	100.0	100.0	100.0	6.10	6.86	5.59	5.36	5.03

Source: Prepared by the IMF mission with MEF/SUNAT data. Notes:

(1) Includes corresponding proportion of regularization of natural persons.

(2) Includes regularization of legal persons.

(3) Assumes all regularization of work income corresponding to the fourth category.

(4) Includes Special Regime, MSE Tax Regime (2017), and other income.

(5) Period January–September 2021

68. **The collection structure for income tax on capital income is regressive.** The income tax rate is constant, by design, even if this type of income increases. Even the average effective rate (AER) by income range decreases slightly for higher brackets, while the highest rate is paid by people with the lowest income, that is, from 0 to 5 UIT (Figure 24).¹²

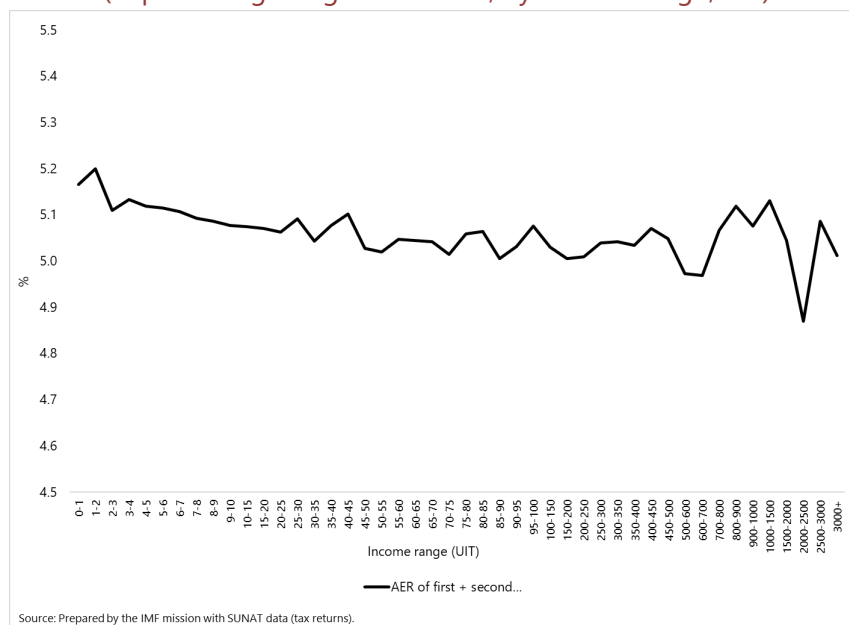
⁹ The decrease in income tax revenue from legal persons is notable. From 2010 to 2014, it fell on average from 4.4 percent of GDP to 3 percent in the five-year period that followed.

¹⁰ Income tax on capital gains was 1.0 and 1.4 percent of GDP, respectively, in 2018. It was slightly higher in Estonia (1.7 percent), but that country does not have, for all practical purposes, income tax for legal persons (OECD Global Revenue Statistics Database). The international comparison in this area (see Annex I, Table A1) provides little information because countries often do not disaggregate revenue derived from income tax on capital income or do so only partially.

¹¹ This analysis is beyond the scope of this report, which, at the request of the MEF, is limited to examining the fiscal regime of the mining sector, capital gains, and VAT on digital services.

¹² Disaggregated data on the AER by income bracket shown in Figure 24 can be found in Annex I, Table A2. The database was compiled by SUNAT based on various information returns submitted by taxpayers.

Figure 24. AER on Total First and Second Category Income, 2020
(In percentage of gross income, by income range, UIT)



69. **The income tax design applicable to the main first and second category income in Peru is discussed below, as are dividends received by legal persons.** The main features of the respective regime are described first, followed by an analysis of the structure of each one (base, rate, and exemptions) and a comparison with statutory practices in other countries. The income considered is rental income (first category) as well as proceeds from the disposal of real estate, shares, and debt instruments and interest income (all second category). The discussion on dividends includes dividends received by legal persons (third category). Foreign or Peruvian source capital gains obtained by residents abroad are not analyzed in this report.¹³

B. Rental Income

70. **Rental income, which makes up the vast majority of first category income, has a specific schedular treatment.** The income tax base of natural persons in this case is, in principle, gross rental income, subject to a flat rate of 6.25 percent. However, the regime allows a 20-percent reduction of the base, which reduces the rate, for all practical purposes, to 5 percent (Income Tax Law, Art. 84). The base cannot be decreased due to losses in other types of capital transactions, and

¹³ In the request for delegation of powers, the MEF did not present an initiative to reform international aspects of the income tax. The IMF provides its members with technical assistance in reviewing such income tax aspects, when such assistance is requested, considering that the capacity to manage international matters is key to the system's effectiveness.

other deductions are not permitted. This regime was introduced in 2009, and collection of this tax dropped significantly from that year onward, recovering as a proportion of GDP in 2014.¹⁴

71. **The tax base is subject to a minimum value for income tax purposes.** The rent amount cannot be less than 6 percent of the (self-assessed) cadastral value of the property (Income Tax Law, Art. 23). When the rental agreement is between related parties, the remuneration will have to comply with the principle of independence, that is, the transaction must be agreed at market value for tax purposes (Income Tax Law, Art. 32-A). The effectiveness of this method depends on updated cadastral values. In Peru, however, there is a major gap in this respect (Schatan et al., 2016).

72. **The tax treatment of rental income is advantageous for those who earn employment income.** This income (*fourth category*, self-employment, and *fifth category*, dependent employment) is subject to a progressive rate that maxes out at 30 percent for annual income above 45 UIT, counted from the tax-exempt bracket of 7 UIT. As expected, the AER for high-income earners increase considerably. For example, persons with total income above 300 UIT paid an AER of 24 percent on their fifth category income (see Annex I, Table A2).

73. **One policy option is to align the rental income regime with employment income.**¹⁵ If the increasing structure of effective rates on fifth category income were to apply to rental income, collection from this category could double to potentially S/. 1.15 billion (2020) or 0.16 percent of GDP (see Annex I, Table A3), which is double the average annual collection for the period from 2015 to 2019.¹⁶

74. **The effect would be progressive** because the increase in collection would come from the 15–20 UIT and higher income brackets, with 80 percent of the increase concentrated among persons with income above 80 UIT (who account for less than 0.5 percent of all taxpayers). Below the 15–20 UIT income bracket, the tax burden would actually be reduced, including for those incomes up to 7 UIT that would remain exempt (Figure 25). Aligning the regimes would be equivalent to increasing the current rental income rate to 14 percent (see Annex I, Table A3). This calculation does not take

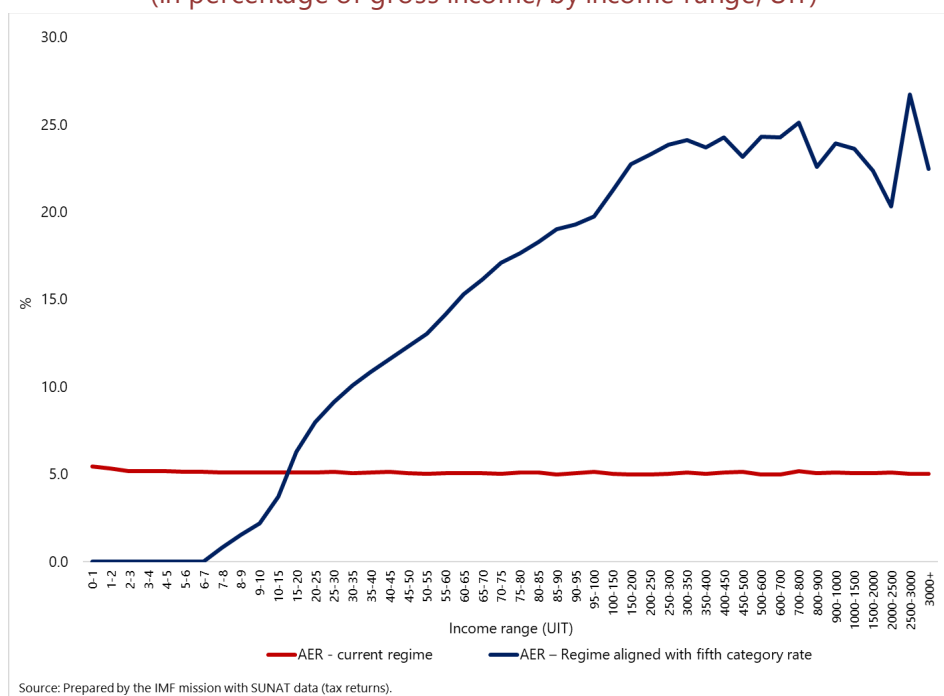
¹⁴ Until 2008, rental income was taxed in accordance with the progressive marginal rates applicable to the income of natural persons. From 2005 to 2008, first category income tax collection represented 0.07 percent of GDP. In 2009, this percentage fell to 0.04 and remained there until 2011. It then increased to 0.07 again in 2014, surpassing this percentage only in 2016.

¹⁵ Like the regime in Peru until 2008.

¹⁶ The estimated increase in collection after changing the first category income regime to a progressive system is S/. 640 million (S/. 1.15–0.51 billion—collection recorded in 2020; Table 12). However, in a scenario where, for example, 55 percent of the rental income (persons with income above 45 UIT) is subject to the highest marginal income tax rate (30 percent), collection could reach 0.22 percent GDP, over 0.15 percent extra, which is very close to the MEF estimate (0.14 percent of GDP in 2022). These amounts could be minimally overestimated due to the fact that data on fifth category withholdings developed by SUNAT do not take into account income tax refunds to persons. Nevertheless, considering the data available on deductible expenses for natural persons with fourth and fifth category income, the difference is very small.

into account the potential change in the marginal rate by adding rental income to employment income. This is therefore a conservative calculation.¹⁷

Figure 25. First Category Income Tax AER and Alignment with the Fifth Category Rate, 2020
(In percentage of gross income, by income range, UIT)



75. **Both in Mexico and in Chile, rental income is added to total income (it is cumulative),** to which the general progressive rate for natural persons is applied (Global Complementary Tax in Chile).¹⁸ In both cases, activity-related expenses can be deducted. In Mexico's case, there is an option of a general blind deduction of 35 percent of gross income, plus a very specific deduction, such as property tax. The blind deduction is a simplification that facilitates compliance. However, exempting documentation to deduct expenses does not promote formality. Introducing a progressive regime for rental income in Peru could make it possible to accommodate the current general deduction of 20 percent and the option to deduct itemized documentable expenses.

76. **The higher the tax pressure, however, the greater the risk that lessees will opt for informality.** The risk is high in Peru because its informal economy is (proportionally) one of the

¹⁷ For example, for those with employment income that hits the highest marginal rate, any extra income in the overall amount means that the income is taxed at 30 percent and not at the AER. The calculations use data on fifth category income and deductions only, since the information on fourth category income and collection by income range (tax return database) is less complete and represents a smaller percentage of total employment income. Conversely, total fifth category collection disaggregated by income range represents 98 percent of aggregate collection in the same category of the Tax Note published by SUNAT.

¹⁸ In Chile's case, social interest housing rentals (DFL2) are exempt from income tax, for up to two properties. In Mexico, rental income from property is added to total income earned under Article 152 of the Income Tax Law.

largest in the world (45 percent of GDP in 2018), ranked 147th out of 156 countries.¹⁹ Tax payment compliance is a tax administration matter, which is beyond the scope of this report. However, it is worth noting that only 170,000 annual tax returns are filed for first category income, when there could be more than a million rental homes in Peru.²⁰

77. **To reduce informality in the sector, since 2017 the law has permitted deducting up to 30 percent of rent** from fourth and fifth category income (Income Tax Law, Art. 46). This deduction, added to all the other personal deductions authorized by the Income Tax Law, has a total cap of 3 UIT. However, the benefit could be excessive given that its function is to simply generate useful information so that SUNAT can oversee compliance with lessor obligations. This deduction also has a regressive aspect because it does not benefit persons with the lowest income, up to 7 UIT, as they have no tax to reduce. This could prove particularly costly if the rental regime is reformed into a global one in which first category income is also exempt up to 7 UIT. The benefit could be cut in half and still be enough for lessees to take advantage of.²¹

Recommendations

- Amend the current flat rate regime for first category (rental) income to make it progressive, applying the same tax rate as for employment income (fourth- and fifth-income categories).
- Allow for a general deduction of 20 percent of gross income or deductions for documented individualized expenses.
- Reduce the rent deduction to 15 percent of the rent amount paid.

C. Capital Gains

78. **Under Article 2 of the Income Tax Law, capital gains are defined as income from the disposal of “assets that are not intended to be marketed in the course of business.”** This includes income from the sale of shares (including their redemption), certificates, securities, bonds, commercial paper, shares in mutual investment funds, bearer obligations, and, in general, all transferable securities and immovable property, as well as income from the disposal of businesses or companies. This is regardless of whether the disposal made by the domiciled person occurs abroad or is from securities of non-resident issuers.

¹⁹ World Bank, *Informal Economy Database*, available at: <https://www.worldbank.org/en/research/brief/informal-economy-database>. 2017 ranking. See also Medina and Schneider (2018).

²⁰ According to the Population and Housing Census of Peru (2017), the country had 10.1 million private dwellings, 12.4 percent of which are rented out. See: <http://m.inei.gob.pe/prensa/noticias/en-el-pais-existen-mas-de-diez-millones-de-viviendas-particulares-censadas-10893/>.

²¹ In Chile, for example, lessees do not deduct part of their rent, but must file an information return of their status (form 1835).

79. **Taxes must be paid** by natural or legal persons domiciled in the country (residents) as well as non-domiciled persons obtaining capital gains from a Peruvian source.²² Indirect disposals by non-domiciled persons of securities or shares issued by persons domiciled in Peru or of real estate located in the country are also taxed.²³

80. **Capital gains obtained by legal persons are subject to the general corporate income tax regime.** The tax base is the gain from the disposal of the capital asset, that is, income from the sale of the asset less the computable (and demonstrable) acquisition cost in each case. These gains are treated in the same manner as business profits (third category) and are taxed at the general tax rate (29.5 percent). This is generally the international practice, as shown in Table 13. The exception to this rule in Peru is that the exemption on the disposal of shares on the stock market applies to legal persons.

Table 13. Income Tax on Capital Gains – (Resident) Legal Persons, 2021 (*)

Country	Fiscal regime
Peru	General income tax rate applies.
Germany	General income tax rate applies.
Argentina	General income tax rate applies.
Brazil	General income tax rate applies.
Canada	Fifty percent of capital gains are taxed at the general income tax rate.
Chile	General income tax rate applies.
Colombia	Capital gains are taxed at 10%.
South Korea	General income tax rate applies.
Spain	General income tax rate applies.
United States	General income tax rate applies.
Mexico	General income tax rate applies.
Netherlands (**)	General income tax rate applies.
United Kingdom	General income tax rate applies.
Source: PricewaterhouseCoopers (PwC). Notes: (*): Selected countries based on position as source of FDI (according to IMF Coordinated Direct Investment Survey – CDIS) in Peru. (**): Capital gains from qualifying holdings are exempt.	

81. **One aspect of this general regime that could be generous** is the option for legal persons to reduce business profits subject to tax by the losses incurred from the disposal of shares outside the stock market. This can lead to some aggressive tax planning.²⁴ Conversely, the tax treatment of capital gains for natural persons in Peru (second category income) is schedular and has a series of other particularities, discussed below.

²² Proceeds from the disposal of shares or securities from an issuer constituted or established in the country or of immovable or movable property (assets) located in the national territory are considered Peruvian source income, even if the disposal is made by a non-resident.

²³ This last aspect of the tax regime for capital gains is not analyzed in this report; there is no proposal to reform it.

²⁴ One option for decreasing business profits is to generate losses by disposing of the shares of a subsidiary to a third-party affiliate of the group or to the same subsidiary with the option to repurchase later.

Disposal of Real Estate

82. **Income from the disposal of real estate can be second or third category, depending on the “regularity” of the sale.** If the sale is occasional, the income is second category (capital gain). If the sale is regular, the income is third category (business profit), even for a natural person. The sale becomes “regular” as soon as a third disposal is made in a single fiscal year. The rate is 5 percent of the gain in the case of a non-regular sale.

83. **The law provides for a broad exemption on gains from the sale of real estate.** For natural persons, the disposal of all immovable property acquired prior to 2004 is exempt. The sale of a dwelling inhabited by the seller (domiciled natural person) for at least two years at the time of sale is also exempt (Income Tax Law, Art. 4). The exemption applies regardless of the value of the dwelling, or the gain obtained from its disposal. Another condition is that the dwelling does not generate income derived from trade or business activity, even when the owner who disposes of it lives in it.

84. **The gain from the disposal of real estate excludes the inflationary component.** In this case, the acquisition cost of the property is indexed by the “monetary correction index” developed by the MEF. This way, only the actual gain from the disposal of the property is (correctly) taxed.

85. **The intent of the current administration is to increase the tax burden on capital gains.** As indicated in the sections that follow, there would be some room to increase rates; to do so, the neutrality of the regime would also have to be preserved. For this reason, the rate applicable to the sale of real estate should be in line with that the income tax on other capital gains or income. The more complex question is whether to limit the exemption to the sale of dwellings that yield profits above a certain amount reflecting a very high accumulation of wealth, like in other countries.²⁵

Recommendations

- Raise the rate for gains from the sale of real estate in line with the income tax rate for other capital gains or income.
- Explore the possibility of setting a cap on exempt income from the sale of residential housing.

Disposal of Shares

Domiciled Natural Persons

86. **The tax base is the gain from the disposal of the security,** that is, income from the sale of the asset less the computable (and demonstrable) acquisition cost in each case. There is no

²⁵ For example, in the United States, gains up to US\$250,000 per person and up to US\$500,000 per couple are exempt (U.S. Taxpayer Relief Act of 1997). In Mexico, the exemption applies for an amount close to US\$200,000. Any excess is taxed at the average marginal rate for the past five fiscal years (Income Tax Law, Art. 93, Section XIX).

computable cost when the share is acquired free of charge.²⁶ Natural persons can offset the loss only against capital gains in the same fiscal year.²⁷ The regulation contains another set of special rules for establishing the acquisition cost when the share was not obtained through a purchase/sale operation, which are appropriate.²⁸

87. **However, the computable cost of securities is not indexed to inflation.** This means that the tax base includes an inflationary component for the period since the acquisition until the disposal of the security (unlike immovable property, which is indexed, with only the actual gain being taxed). This is a distortion that should be corrected, especially if the proposal is to increase the tax rate.

88. **The legislation in turn grants a generous benefit to reduce the tax base** (Income Tax Law, Art. 36). This is a general deduction for natural persons, additional to the computable acquisition cost of the asset or security in question, through which net (or taxable) income is reduced by 20 percent of gross income (sale price).²⁹ This benefit could well be eliminated, making the regime more equitable with respect to the tax burden on employment income, especially if the acquisition cost of the disposed asset is indexed to inflation.

89. **The general income tax rate applicable to gains from the disposal of shares is 6.25 percent.** This rate applies to Peruvian source gains.³⁰ Foreign source capital gains are taxed at the progressive marginal rate scale from 8 to 30 percent, except those marketed in the Latin American Integrated Market (MILA), in which case they are taxed at a rate of 6.25 percent.³¹ In that case, the permitted 20-percent reduction of the tax base does not apply. Capital gains from the disposal of foreign source shares are, in turn, added to employment income and are taxed at the progressive rate.

²⁶ In the case of legal persons, the acquisition cost is the “value of income to equity,” defined according to the Regulation of the Income Tax Law as market value.

²⁷ The regime applicable to legal persons in Peru is different. Legal persons can offset the loss against all national source profits and can carry them forward for up to four fiscal years. Countries do not always permit broad offsetting of these losses against any other business income. In some countries (such as Mexico), the treatment of these losses, including for legal persons, is schedular, allowing their use only against capital gains of the same kind to avoid aggressive tax strategies. This also prevents a reduction in the company’s operating profit due to the sale of shares to related parties at a discounted price, but whose market value is difficult to establish.

²⁸ There are special rules for determining the computable cost of shares obtained from the capitalization of profits (or liabilities), reserves, or restructured debt (Asset Restructuring Law) and for shares received through reorganization (mergers and divisions).

²⁹ This benefit applies to all first and second category capital income, except for dividends (Income Tax Law, Art. 24(i) and 36). Taxation of dividends is discussed in section 4 of this chapter.

³⁰ Law 30341, Law Promoting the Liquidity and Integration of the Securities Market (2015).

³¹ The MILA is an initiative to integrate and strengthen operation in the securities markets of Peru, Chile, Mexico, and Colombia. An investor who resides in Peru can trade securities traded on the stock markets of other countries from the BVL and vice versa. The treatment of gains is similar to that of a security disposed of outside the stock market in Peru, taxed at 6.25 percent, but without the benefit of the 20-percent general deduction. The rest of the MILA member countries have not progressed in a reciprocal treatment for their residents who invest in Peruvian securities.

Exemption from Sale in the Stock Market

90. **The sale of shares in the BVL is exempt.**³² The purpose is to encourage capital market growth in the country. The exemption benefits resident and non-resident natural persons. The benefit applies when the issuer is domiciled or constituted in Peru, as long as the security is liquid, and not more than 10 percent of the issuer's value is transferred. The exemption was introduced in 2016 for a renewable period of three years and is valid until December 2022. Stock market operations had been taxed since 2010. Despite the tax exemption, the BVL has not shown outstanding performance (Box 5).

Box 5. Tax on the Disposal of Shares on the Stock Market

Reclassification of the BVL as a "border market"

Sequence of events:

- A tax on capital gains from stocks traded on the BVL was introduced in 2010 (rate = 6.25 percent net gain).
- In 2015, market liquidity had decreased substantially.
- Also in 2015, Morgan Stanley Capital Investment (MSCI) announced that it intended to review the "Peru Index" to consider the reclassification of the BVL as a "frontier market," a downgrade from the then-current ranking of "emerging market."
- The exemption on the sale of shares in the stock market was reintroduced in 2016.
- The downgrade was avoided (announced in June 2016).
- The exemption was renewed in 2019 and continues to be in effect.
- The BVL was reclassified as a "frontier market" in March 2020 by another index, the Financial Times Stock Exchange (FTSE) Russell.

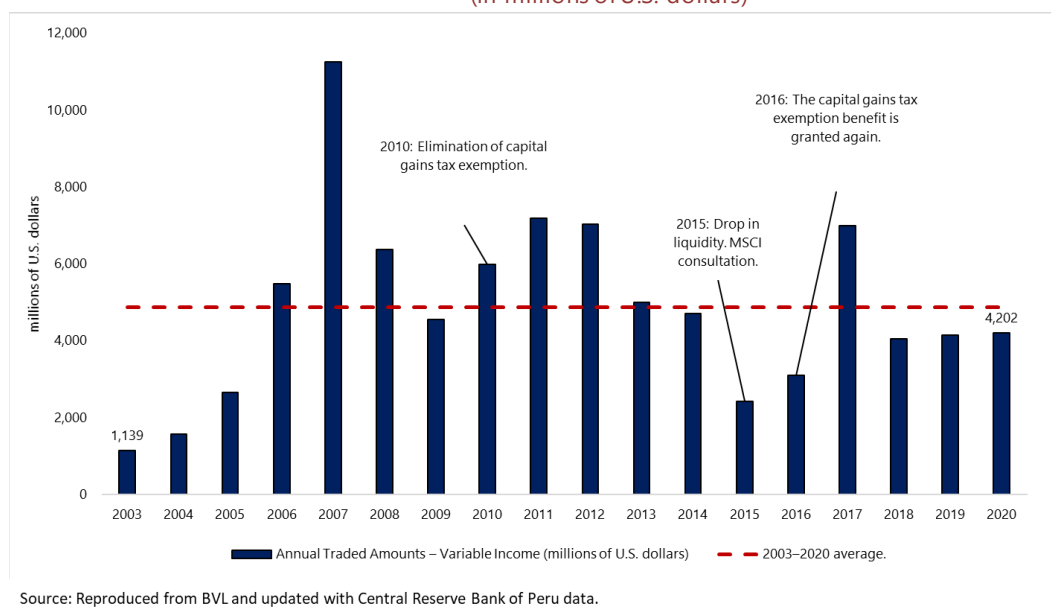
Note:

- In 2010–2012, the first three years during which the tax was in force, the traded value on the BVL ("variable income traded amount") increased (Figure 26).
- The average value of the amount traded in 2010–2012 was higher than in any of the years prior to 2010, except for 2007.

³² Law 30341.

Figure 26. BVL: Annual Traded Amounts – Variable Income, 2003–2020

(In millions of U.S. dollars)



- The MSCI announcement of the possible BVL reclassification in 2015 could partly explain the stock market's worst annual performance since 2006.
 - The threat of reclassification as a "frontier market" was due to not only the low market liquidity in 2013–2014, but also the reduction in the number of securities traded on the stock market that qualified as investment grade according to MSCI parameters to three (the minimum). At the same time, one of the three securities (Southern Copper) changed its place of incorporation to the United States, where its securities are currently traded. In principle, this security should have been removed from the "Peru Index."
 - The reduction in the number of investment grade securities began in 2013.
 - BVL activity recovered significantly in 2017, the year after the exemption was reintroduced.
 - Nevertheless, the average of traded securities in 2016–2020 was lower than in 2010–2015, when the BVL was taxed and affected by the MSCI announcement.
 - The reclassification to "frontier market" by the FTSE occurred in 2020, four years after the exemption took effect.
- It is therefore unclear whether a direct connection exists between the entry into force of the tax on capital gains from stock market transactions and the BVL's downgrade to "frontier market."

91. **The asymmetrical treatment of the disposal of shares and dividends creates a distortion.** The share price reflects not only the expectation of future dividends from the issuer, but also the amount of retained earnings. Therefore, the sale of a share represents, at least in part, the realization of retained earnings. If the tax burden on dividend distribution³³ is greater than the tax burden on the disposal of shares, the expectation is that companies will refrain from distributing dividends and shareholders will realize them by selling shares in the market. For all practical purposes, a door is left open for avoiding tax on dividend distribution.

³³ The tax regime for dividends is discussed in the next section of this chapter.

92. **A classic income tax system taxes business profits twice, once at the top of the company and again when the dividends are received by the shareholder.** The argument in favor of such a system, instead of an integrated one that taxes business profits only once, is the tax policy decision to make the fiscal regime more progressive. It is about striking a balance between equity and the point at which the tax burden on profits begins to inhibit investment, such that the net effect is negative. In this context, while the burden is not excessive, the recommendation would be to eliminate the exemption on capital gains from the stock market and, similarly, for the tax to be equal to the dividend tax.³⁴

International Comparison

93. **There is no standardized international practice.** On the contrary, the fiscal regime applicable to capital gains varies significantly from one country to the next (see Annex I, Table A4). Few countries exempt them entirely, and the majority are low-tax territories. The Netherlands is one particular case that exempts them, but instead taxes a presumed yield of 4 percent on assets at a fixed rate of 30 percent. Some countries simply apply a fairly high flat rate (Germany – 26.375 percent) or quite a low one (Peru – 5 percent) or apply the general income tax regime applicable to natural or legal persons (Spain). Others still do so with particularities, with a reduced fixed rate for stock market transactions (Mexico – 10 percent), full stock market exemption (Chile – under review), or a 50-percent reduction on the base (Canada). Other regimes are characterized by a special simplified but progressive rate (United Kingdom). The applicable rates also vary depending on the transaction amount or the shareholding percentage, if the issuing company is small or medium (Korea), or if the holding was short- or long-term (United States, Colombia). Like Peru, Colombia and Argentina exempt disposals on the stock market. The majority of countries have a (fairly low) threshold below which annual capital gains are exempt. Despite the variety of regimes described by the revised sample, the Peruvian regime (5 percent fixed rate and stock market exemption) seems remarkably generous by comparison.

Recommendations

- Allow the exemption on the disposal of shares in the BVL to expire in 2022.
- Tax capital gains realized in stock markets associated with the MILA like all other foreign source gains (apply the progressive rate).
- Eliminate the blind general deduction of 20 percent of gross income to determine the taxable gain.
- Keep the flat tax rate low, like the one applicable to dividends, at not more than 10 percent (see section 4).
- Index the acquisition cost of shares to inflation and avoid taxing net nominal profits.

³⁴ A draft law recently tabled in the Chilean Congress similarly proposes eliminating the exemption on the disposal of shares on the stock market, applying a flat rate of 5 percent to capital gains; see Garrigues (2021). Mexico eliminated the stock market exemption in 2014.

- Exempt a relatively small amount of annual capital gains.
- For legal persons, apply a schedular treatment to losses from the disposal of shares so that they are deductible only against gains of the same kind.

D. Dividends

Natural Persons

94. **The tax on dividends, in principle, taxes the same income subject to income tax on business profits.** As explained earlier, the drawback is that it increases the investment cost; although, within certain limits, it is normally justified on the understanding that it adds progressivity to the tax regime.³⁵

95. **There are at least three types of tax regimes applicable to dividends that reflect this situation in one way or another.** One is entirely integrated, where a company's distributed dividends are added to the income of natural persons and the company's income tax is fully credited against the income tax rate for natural persons, such that the additional burden on the dividends received by the shareholder is just for the difference between the corporate income tax rate and the income tax rate applicable to natural persons (e.g., Chile and Ecuador). In the second, dividend distribution to ultimate shareholders is exempt (e.g., Brazil). In the third, dividend distribution is taxed by a final or definitive withholding at a relatively lower fixed rate, in addition to corporate income tax (i.e. Peru, Argentina, and Uruguay)³⁶ (see Annex I, Table A5).

96. **Dividend distribution in Peru is taxed at the (definitive) rate of 5 percent.** Domiciled legal persons that distribute dividends³⁷ to natural persons are required to withhold and remit this tax. This is a schedular tax on the income of natural persons, without effect on the progressive rate (scale) of the income tax. In Peru, the combined rate for profits is 33 percent, a competitive burden compared to the burden in other countries (Table 14).³⁸

³⁵ See, for example, U.S. Department of the Treasury (1992).

³⁶ Mexico has a hybrid system in which dividends are added to the rest of the income, corporate income tax is credited, the difference is paid at the progressive rate, and the dividend is subject to a definitive withholding of 10 percent on the flow. For a profit of 100, for example, after corporate income tax of 35 percent (credited against the 30-percent income tax for natural persons), followed by a 10-percent withholding on the net dividend, the distributed profit ($65 - 6.5$) is 58.5 and the combined tax ($1 - 0.585$) is 41.5 percent.

³⁷ The definition of "dividend" in the Income Tax Law is broad and incorporates taxation assumptions for the distribution of profits through the reduction of capital or liquidation of the legal person, accruals by founding partners, labor shares, or other concepts that confer the right to participate in the capital or earnings of the company.

³⁸ The combined effective rate normally results from applying the withholding to the dividend net of income tax. When an integrated system is involved, as is partially the case in Mexico, the income tax of natural persons is applied to the pyramid dividend of the corporate income tax, minus the credit that corporate income tax represents. The net dividend calculated in this manner is the basis of the additional withholding.

Table 14. Corporate Income Tax and Withholding on Dividends (Residents* and Treaties), 2021

Country	Rate (%)			
	Corporate income tax	Residents	Combined	Treaty minimum
Austria	25.00	27.50	45.63	0.00
Italy	24.00	26.00	43.76	5.00
Mexico (**)	30.00	10.00	41.50	0.00
Costa Rica (***)	30.00	15.00	40.50	12.00
Argentina (****)	35.00	7.00	39.55	7.00
Colombia	31.00	10.00	37.90	0.00
Peru	29.50	10.00	36.80	10.00
Poland	19.00	19.00	34.39	0.00
Dominican Republic	27.00	10.00	34.30	10.00
Brazil	34.00	0.00	34.00	0.00
Peru	29.50	6.25	33.90	10.00
Peru	29.50	5.00	33.00	10.00
Honduras	25.00	10.00	32.50	n.a.
Panama	25.00	10.00	32.50	5.00
Czech Republic	19.00	15.00	31.15	5.00
Uruguay	25.00	7.00	30.25	5.00
Greece	24.00	5.00	27.80	5.00
Slovakia	21.00	7.00	26.53	0.00

Source: International Bureau of Fiscal Documentation (IBFD), OECD. Notes: (*) Does not include countries with an integrated income tax regime (for example, Chile). (**) Hybrid integrated income tax; calculation assuming high NP income tax rate of 35%; additional 10% integrated burden. (***) Progressive rate of 5–20% for companies with income below S/. 109,337,000. (****) Progressive LP income tax rate of 25–35%.

97. **The progressive income tax rate for natural persons applies, in turn, to dividends received abroad.** If a non-resident corporation distributes dividends to domiciled natural persons, the income is added to other foreign source income (and to net employment income), and the income tax is calculated in accordance with the progressive marginal rate regime.

98. **The 5 percent rate on dividends is equal to or lower than that of other countries in the region.** For example, the withholding rate in Honduras, Panama, Mexico, Costa Rica, and the Dominican Republic is 10 percent, whereas in Argentina and Uruguay it is 7 percent. There are also countries where dividends are considered ordinary income and are added or accumulated with the other income, to be taxed at the corresponding progressive rate, with a credit for corporate income tax that the company would have paid. The tax burden on dividends in this case will depend on the income tax marginal rates applicable to natural persons and the corporate income tax rate (Table 14 and Table A5 in Annex I).³⁹

Policy Options

99. **One policy option, with a view to strengthening the neutrality of the regime and slightly increasing its progressivity, is to raise the withholding rate on dividends to 6.25 percent.** The statutory rate would then be consistent with the rate applicable to the disposal of shares and to rentals; if the proposed measure of eliminating the 20-percent general deduction for

³⁹ That is the case with Chile, which offers the option of a fully integrated regime; when the income tax paid by the company is higher than the shareholder's burden, the shareholder is entitled to a reimbursement for the difference. The regime in effect in Mexico until 2013 was the same. Currently, shareholders receiving the dividend, in addition to paying the integrated income tax that might apply to them, must pay an additional tax of 10 percent on the dividend amount.

such income is adopted, the effective rates would also be consistent. The tax rate would remain below the prevailing rate in many of the region's countries, with the combined rate rising to 34 percent. There would be room to raise the rate further; a rate of 10 percent could be the limit,⁴⁰ as it would bring the combined rate to a high relative position in the region (Table 14).

100. **Another option is to add the dividends to the person's other income and apply the progressive rate to the overall amount, after crediting the corporate income tax.** Although this option could contribute to the fairness of the regime by aligning the tax burden with that of employment income, it also entails greater compliance and control difficulty. The tax authority must inspect natural persons who receive dividends, a much broader universe than the number of companies that distribute them. At the same time, given that the higher marginal rate applicable to natural persons in Peru is barely higher than the income tax rate for legal persons, the combined tax burden would be marginally higher. If the refund of excess credit is allowed for shareholders whose income does not reach the higher marginal rate in their individual income tax, the result could even negatively affect collection.

Weaknesses of the Current Regime

101. **One weakness of this tax is that it depends on the company's decision to distribute dividends to its ultimate shareholders.** Retained earnings only pay corporate income tax, whereas dividend tax can differ at the discretion of the shareholders controlling the company. This creates an incentive for shareholders to find other ways to dispose of company profits without having to formally distribute profits. For example, shareholders can incur personal expenses through the company and (unduly) deduct them from business expenses. It is also common for companies to grant loans to their shareholders (under potentially highly favorable conditions). Transnational companies have other more sophisticated options for transferring profits by manipulating transfer prices in their operations with foreign affiliates, thus avoiding withholding on the payment of dividends. For this reason, it is important for income tax to also apply to distributions of "presumptive dividends" (*dividendos fictos*).

102. **The Income Tax Law in Peru establishes the concept of "presumptive dividend," taxing it at 5 percent as well.** A presumptive dividend is a non-deductible expense because it is unnecessary for business achievement and when its destination is not subject to subsequent control by the tax authority.⁴¹ The presumption then is that the expense has been for the benefit of the shareholder. The assumption applies, for example, to the withdrawal of merchandise or other goods for the benefit of the owner (or his or her family) or when used for non-taxed activities.

⁴⁰ Ten percent is also the minimum withholding on dividends agreed by Peru in its treaties to avoid double taxation. This is discussed in greater detail below.

⁴¹ Assumptions regulated in Article 24-A of the Income Tax Law and in Articles 13-A and 13-B of the Regulation to the said law.

Remuneration to a partner (or family members) in excess of the market value as well as loans to partners or shareholders are also presumptive dividends.⁴²

103. **However, the definition is not clear enough.** It is unclear whether the definition covers profits transferred to a related party through the manipulation of transfer prices or the overpayment of interest above the deductible established by the specific anti-abuse rule (30 percent of EBITDA).⁴³ It is unclear whether, in these cases, it is assumed that the expense escapes SUNAT's control or whether the concept of presumptive dividend applies to transfer price adjustments that do not affect deductible expenses. Therefore, there would be greater protection for the tax base if adjustments to profits due to changes in transfer prices in operations with related parties or due to a reduction in the interest deduction expressly had the same treatment as presumptive dividends under the law. This would have to include the rental of a property owned by the shareholder, for the amount that exceeds the market value, because the operation can be used to transfer resources to the lessee partner, taxed at 5 percent (withholding on first category income), while being recorded as a deductible expense for the company at 29.5 percent.

104. **Loans to partners or shareholders are reclassified as presumptive dividends up to the limit of freely available profits or reserves** (Income Tax Act, Art. 24-A). The rule does not apply to loans granted to related parties (family members) of partners or shareholders. This is a major limitation of the regime. These loans, as well as the amount lent to partners or shareholders in excess of freely available profits, are not treated as presumptive dividends, but are rather maintained as loans for tax purposes. Instead of being subject to withholding, the regulation requires that such loans earn interest for the company not less than the "monthly average market lending rate in national currency" (Income Tax Law, Art. 26). However, this does not appear to be a sufficient safeguard.⁴⁴

105. **The amount of loans to shareholders is considerable.** According to SUNAT data, from 2017 to 2020, close to a quarter of distributable Peruvian company profits were distributed to shareholders as loans, and, of that amount, only 15 percent were treated as a distribution of presumptive dividends (Table 15). This is symptomatic of a tax avoidance problem. The standard should be amended to broaden the universe of this type of loan, which should be clarified as a presumptive dividend,⁴⁵ in addition to giving equal treatment to loans to family members of company partners and shareholders, according to the definition of "related" in the Income Tax Law,

⁴² The presumptive dividend is limited to the amount of profits available to the partner. The surplus retains its nature as a credit. In Mexico's case, pursuant to Article 140, sections II and III, of the Income Tax Law (for natural persons) and Article 11 of the same Law (for legal persons), these loans are considered dividends.

⁴³ This limitation was included in the Income Tax Law in lieu of the "small capitalization" of 3 to 1 debt-capital rule.

⁴⁴ In principle, it could be argued that only payments in favor of partners or shareholders (not their family members) can be characterized as a presumptive dividend. However, there is a precedent that the law considers it a presumptive dividend when family members benefit from the withdrawal of assets owned by the company or are paid above the market standard.

⁴⁵ For example, cases in which the interest paid to a partner is determined based on company profits.

Art. 24. In Mexico for example, all loans to partners or shareholders are characterized as distribution of presumptive dividends, even if they exceed the limit of freely available profits, if they meet certain conditions.⁴⁶

Table 15. Distribution of Company Dividends, 2017–2020

Component	2017	2018	2019	2020	2017–2020
	millions of soles				%
Earnings freely available to shareholders	65,279	70,584	81,828	65,642	100
Distributed with withholding	21,725	23,479	34,350	24,378	37
Dividends to domiciled LPs	8,025	9,425	12,425	9,120	14
Loans to shareholders	15,708	16,626	18,417	18,124	24
Classified as presumptive dividends	2,726	2,428	2,893	2,143	4

Source: Prepared by the IMF mission with SUNAT data.

Legal Persons

106. **The tax regime for dividends is different when the beneficiary is a legal person.** There is no tax when the dividend is distributed between resident companies. Tax is incurred only when the dividend is paid to the ultimate shareholder or to a resident abroad. For dividends paid by non-domiciled companies that are received by domiciled legal persons, the rate applicable is the general corporate income tax rate (29.5 percent).⁴⁷ This allows for the free flow of profits between companies in the same group, maximizing the amount of funds available for reinvestment inside the group. Even when the dividend is advanced, the distribution can occur before corporate tax is paid.

107. **The exemption from withholding on dividends distributed between domiciled companies is a common practice (Table 16).** This is to avoid a cascading effect as long as the dividend does not leave the group of companies owned by shareholders because the subject of the tax is the natural person shareholder (except when a resident abroad is involved).

⁴⁶ Loans that are a normal consequence of the operation, are agreed for less than one year, and have an interest rate equal to or greater than the rate established for tax credit payment arrears are not presumptive dividends.

⁴⁷ Pursuant to Article 88 of the Income Tax Law and Article 52 of the Regulation to the said law, they can deduct the income tax paid abroad by the non-domiciled corporation at the first level, provided that shareholding is greater than 10 percent. To this end, income must be pyramided with the tax paid abroad; the credit limit is the tax payable in Peru.

Table 16. Selected Countries (*): Tax on the Distribution of Dividends Between Companies

Country	Fiscal regime
Germany	Exemption on intragroup distribution; withholding on ultimate shareholder.
Argentina	Exemption on intragroup distribution; withholding on ultimate shareholder.
Brazil	Exemption on intragroup distribution; withholding on ultimate shareholder.
Canada	Exemption on intragroup distribution or withholding on first distribution with credit (depending on type of company).
Chile	Exemption on intragroup distribution; withholding on ultimate shareholder.
Colombia	Exemption on intragroup distribution; withholding on ultimate shareholder.
South Korea	Exemption on intragroup distribution; withholding on ultimate shareholder.
Spain	Exemption on intragroup distribution; withholding on ultimate shareholder.
United States	Exemption on intragroup distribution; withholding on ultimate shareholder.
Mexico	Withholding on first distribution and credit on subsequent distributions.
Netherlands	Withholding on first distribution and credit on subsequent distributions.
United Kingdom	Exemption on intragroup distribution; withholding on ultimate shareholder.
Source: IBFD. (*): Main Latin American countries and origin of FDI in Peru (IMF CDIS).	

108. **In principle, the regime could be conducted differently, but with the same result of neutrality.** Instead of the last company in the group that distributes dividends to the shareholder being responsible for withholding and remitting the tax on dividends, it is conceivable for the first company that distributes them to do so. This would involve generating a credit for the rest of the intragroup distribution chain, including the final one in favor of the natural person shareholder. However, this system is less frequent (Table 16). Alternatively, the receipt of the dividend could be deducted from the dividends distributed by the recipient (and so on and so forth), with tax paid only on the difference (U.S. system).

109. **However, Peru does not have a straightforward oversight system to this end.** The law does not require companies to keep a specific control account for profits on which corporate income tax has already been paid, or the dividends received, which would be necessary to administer a system that taxes the first dividend distribution. There is also no obligation for the dividend to only be distributed once corporate income tax has been paid, which should be required regardless of the withholding modality for distributed dividends.

Non-domiciled Persons

110. **The general withholding rate for dividends paid to residents abroad is also 5 percent.**⁴⁸ Note that this rate is lower than the one Peru has negotiated in treaties to avoid double taxation. Peru has signed treaties with 11 countries, and the rates agreed in them are 10 or 15 percent, except

⁴⁸ The 5-percent rate (Income Tax Law, Art. 54 and 56) does not apply to profits distributed due to capital reduction in the 12 months following a capital increase, in which case 30 percent is applied.

for the treaty with the Andean Community.⁴⁹ In this case, the rate applies to residents, that is, 5 percent in Peru. This rate also applies to residents in other countries with a treaty because the Peruvian law represents, for all practical purposes, a unilateral concession for decreasing the tax agreed in the treaty. However, this means that the country can domestically increase the withholding rate for dividends up to 10 percent without violating treaties, including the treaty with the Andean Community.

111. Normally, treaties mutually reduce withholding rates on income paid to non-residents in the source country. Peru has followed the opposite policy because its law provides for a withholding rate for dividends that is lower than what has been negotiated in its treaties. This means that Peru has unilaterally ceded the tax base (by law) compared to what contracting countries are willing to recognize. However, it competes with a number of countries that have agreed (in some cases) on a zero withholding rate on dividends paid to residents from another contracting country (Table 14).

Collection

112. Raising the rates on dividend distribution would lead to a modest increase in collection. According to MEF projections, income tax collection for second category income (Multiyear Macro Framework) will add S/. 2.275 billion in 2022 if the current withholding rate of 5 percent is maintained. According to SUNAT data, dividends represent around 70 percent of second category income.⁵⁰ In an entirely static (and therefore optimistic) scenario, this means that increasing the rate on dividends to 10 percent would lead to collection of around S/. 1.6 billion, or 0.18 percent of GDP, in 2022.

Recommendations

- Maintain the tax on dividends as a flat, moderate rate, withheld as a final tax by the company at the time of distribution.
- Increase the tax rate on dividends received by individuals and non-domiciled persons up to a maximum of 10 percent (the minimum rate agreed in the treaties).
- Keep the rate consistent with the rate applicable to capital gains in general.
- Clarify the definition of presumptive dividends to include transfer price adjustments involving a non-deductible expense in favor of a related party, including the excess rent paid for the lease of a property owned by a partner or family member.
- Characterize loans to family members of partners and shareholders as profit distributions, subject to dividend withholding, up to the limit of freely available profits.

⁴⁹ Decision 578 of the Andean Community of Nations: Peru, Bolivia, Ecuador, and Colombia.

⁵⁰ Source: SUNAT, second category income tax collection.

- Withholding on the first dividend distribution between legal persons should not be considered before adopting a registration system for profits after corporate income tax, in addition to another record related to withholdings that allows tracking of the corresponding credit in intragroup distributions.

E. Interest and Debt Instruments

Regime Description

113. **Interest income is taxable under the income tax.** This includes second category income for domiciled natural persons, income and permitted deductions in the third category for legal persons, and Peruvian source income for non-domiciled persons. The rates range from 5 percent for natural persons to 29.5 percent for legal persons and 4.99 percent for non-domiciled persons.⁵¹ When payment is made to low-tax jurisdictions (*jurisdicciones de baja imposición* – JBI), the withholding rate is 30 percent.⁵² The same rate applies when related parties carry out the operation through a third party (back-to-back loans).

114. **The definition of “Peruvian source” is broad and includes various concepts of interest.**⁵³ All consideration agreed for loans, credits, or any financial obligation is taxed, including premiums and fees, as are factoring operations and, in general, any income derived from participation in funds or life insurance contracts that have a savings component (except when the insurance is contracted by the employer).

115. **However, there are assumptions that remain outside of that.** For example, foreign exchange gains (or losses)⁵⁴ or financial leases are not considered. The law is also unclear about the result of financial operations derived from debt having a treatment equivalent to the various concepts of interest listed above.

116. **There is a minimum presumed interest rate** for all money loans⁵⁵ equivalent to the “monthly average market lending rate in national currency” or the London interbank market

⁵¹ This rate applies if the credit is in foreign currency and the interest rate does not exceed the dominant preferential rate of the place of origin of the loan by 3 points. Otherwise, the rate is 30 percent. These conditions apply to all credits, whether or not they are between related parties (Income Tax law, Art. 56).

⁵² JBIs are those jurisdictions whose nominal corporate income tax rate is less than 60 percent of that applicable in Peru and do not have an information exchange treaty with the country. SUNAT issues a (non-exhaustive) list of JBIs; Income Tax Law, Art. 44, and Regulation to the Income Tax Law, Art. 86 and 87.

⁵³ Art. 9 of the Income Tax Law.

⁵⁴ In Peru, exchange rate adjustments are computed separately as a deduction or income. This leaves foreign exchange gains (losses) out of the computation of the deductible interest limit as a proportion of EBITDA. Companies (with income above 2,500 UIT) can deduct net interest accrued up to 30 percent of net income for the prior fiscal year, after offsetting losses plus interest, depreciation, and amortization.

⁵⁵ Applies when interest is not stipulated or a rate lower than the market rate is established. Does not apply to loans to company employees as a salary advance up to 1 UIT, or up to 30 UIT for housing loans.

six-month average deposit rate (LIBOR) for loans in foreign currency.⁵⁶ In operations between related parties, the presumption does not apply, and the market value will always be used. Compliance with this principle of independence is a requirement for deducting interest paid.

Exemptions

117. **A significant system weakness is the extensive list of exemptions.** Interest derived from public debt (public Treasury bills, bonds, or other securities issued by the Republic of Peru and Central Reserve Bank obligations) are exempt from tax (for both natural and legal persons). As is common, interest from development credits granted by international organizations or government institutions abroad is also “unaffected,” but only until 2023.

118. **There are also broad exemptions for natural persons.** Any type of fixed- or variable-rate interest, in national or foreign currency, on deposits in (or certificates from) financial system institutions, including insurance companies, as well as interest paid by savings and loan cooperatives to their members is exempt. The tax exemption for domiciled persons also applies to fixed-income securities (debt) that bear interest until maturity (zero-coupon bond) that, upon disposal in the securities market, transfer the effect of a capital gain exemption to accrued interest.

Distortions

119. **Maintaining a large pool of untaxed interest income not only is a collection loss, but also introduces inequalities and distortions in the fiscal regime.** It can be assumed that the majority of interest income is earned by higher-income (natural) persons. As long as this is the case, the system will comprise a significant regressive element. Taxing them broadly, however, would have to correct the tax base to exclude (or offset in some way) the inflationary interest component.

120. **At present, when it does so, income tax in Peru taxes nominal interest.** This means that it taxes the inflationary gain as well, instead of just the real gain. This can lead to another major distortion, especially when nominal interest rates for savers remain low and can even be negative in real terms. This will be more frequent for small savers as well. Taxing nominal interest can also be not only regressive, but also confiscatory for them. Introducing interest to the income tax base in general should take this effect into account, taxing only real interest (nominal less the inflationary component). Alternatively (less technically rigorous, but simpler), the exemption on deposits should be maintained up to a certain threshold below which there is evidence that the rate of return does not exceed inflation.

121. **Exempting public debt interest creates another distortion that potentially inhibits private investment.** This means that the public sector competes with an advantage for funds from savers, crowding out private investors because the bonds they issue have to pay a higher nominal

⁵⁶ Various determining factors coexist in relation to deductible interest for debt contracted abroad: one related to the LIBOR, another 3 points above the prevailing rate in the place of origin, and, finally, one that independent parties agree on under similar conditions. The regime could be simplified by harmonizing criteria.

rate to cover the tax component and match the net rate obtained by the saver. Economic efficiency is thus affected because there is less private investment than there would have been otherwise, and the future corporate income tax base potentially decreases (Noregaard, 1997).

122. **Rate asymmetry also gives rise to a distortion in the system.** Natural persons pay 5-percent income tax on Peruvian source interest,⁵⁷ whereas legal persons are taxed at 29.5 percent. This creates an incentive for partners and shareholders to grant credits to their companies, such that interest is taxed at 5 percent and is deductible (for companies) at 29.5 percent.

123. **The tax regime must aim towards neutrality in the capital market.**⁵⁸ The delegation of legislative powers sought by the current administration does not include initiatives to reform the fiscal regime applicable to interest, even though some of its shortcomings are significant. Correcting them is also complicated and warrants further study, especially as concerns inflation correction. Nevertheless, raising the income tax rate on capital gains and leaving the tax on interest income at 5 percent would in itself be an additional distortion. Moreover, maintaining the exemption on some debt instruments that compete in attracting funds from savers with other securities whose gains are proposed to be taxed would further widen the tax gap between one type of investment and others, affecting the system's neutrality. The recommendation is for the income tax rate applicable to interest to be the same as that which applies to capital gains and to steer the reform toward decreasing the scope of exemptions for financial returns.

Recommendations

Incorporate into the medium-term agenda reforms to income tax on interest that seek to:

- Extend the treatment of interest to debt derivatives and to the credit component in financial leases.
- Eliminate exemptions on interest paid by the financial system, including savings instruments issued by insurance companies.
- Eliminate the exemption on public debt interest obtained by residents.
- Maintain the exemption on investment interest below a certain average annual balance.
- Match the tax rate to that established for capital gains and dividends.

⁵⁷ Interest received from a foreign source is taxed at a progressive scale from 8 to 30 percent and is added to employment income.

⁵⁸ Normally, public debt interest acquired by non-resident investors is exempt since, for a relatively small country, the interest rate on its external debt is perfectly elastic.

IV. IGV ON DIGITAL SERVICES

A. Introduction

124. **In Peru, services are generally taxed under the IGV, which includes digital services provided remotely from outside the country** (General Sales Tax Law, Art. 1.b). However, there is no mechanism for collecting tax on imported remote services when dealing with direct sales to the end consumer (Business to Consumer – B2C). Given the intangible nature of the service, the transaction is performed entirely in the digital sphere without any intervention by a person or transit through customs. In principle, the end consumer should be the one to withhold VAT from the non-resident provider and remit it to the treasury. However, not only does the consumer lack an incentive to do so, but this is also not feasible to carry out or oversee. Peru lacks a VAT collection mechanism for B2C digital services from abroad.

125. **IGV taxpayer companies would have no difficulty in meeting the tax obligations when importing digital services.** Companies that acquire digital services (Business to Business – B2B) can reverse the tax charge, fulfilling the role of withholders (on behalf of foreign exporters) at the time of “importation” and crediting it back to them at the same time. They have an incentive to operate in this manner, just as they do to fulfill IGV obligations in the case of any other goods or services imports into Peru.

126. **The reform required by the Peruvian regulation is to operationalize IGV collection in B2C situations.** The initiative being prepared by SUNAT has this purpose, which would help broaden the tax base and eliminate the advantage for non-resident versus national providers. The mission did not see the draft itself but did have the opportunity to discuss its content with institution officials. The comments that follow are based on these conversations held during the mission.

B. International Practice

127. **The issues with implementing VAT for digital services have been extensively discussed and studied recently by international organizations and experts.** There is significant literature on best practices in that regard, including guides and manuals (see OECD, 2017, and OECD, WBG, CIAT, IDB, 2021). There is also some experience in other countries (although relatively short) where this tax is collected, including various Latin American countries. In summary, OECD guidelines recommend, as a basic rule, charging non-resident providers this tax for B2C supplies. Given that normally they are not physically present in the consumer’s jurisdiction of residence, to implement this recommendation it is necessary to design a simplified system, equally remote and digital, so that such providers register, charge, and remit VAT in the jurisdiction in which the consumer resides. This model has been implemented by over 60 countries for imported digital services (Brondolo and Konza, 2021) and has been used in the European Union since 2005.

128. **The practice in Latin America is more varied and includes the obligation for resident third parties to withhold the tax.** Nine countries in Latin America have introduced legislation to apply VAT to digital service imports (Fenochietto, 2021). Chile, Colombia, and Uruguay have followed the OECD model, which encourages remote registration and payment of the tax by providers of imported services. Mexico's regime is particular in that non-resident providers must be registered through the appointment of a representative or legal agent in the country who assumes responsibility for collecting and remitting the tax. This representative does not give rise to permanent establishment, but rather acts as the (virtual) importer of the service.⁵⁹ In other countries (Argentina, Brazil, Costa Rica, Ecuador, and Paraguay), non-resident providers are not required to register with the authority of the country in which the consumer resides, but the country's financial institutions through which payments abroad are made must withhold the tax from digital providers.

129. **Some countries have a "hybrid" system.** In Costa Rica and Ecuador, for example, the service provider can opt to register to avoid withholding. Chile and Colombia also apply a withholding in the event that the provider is not registered. In Mexico, meanwhile, the penalty provided for by law in the event that a provider fails to meet the tax obligations is the cancellation of the Internet service.

C. SUNAT Proposal

Core Elements of the Proposal

130. **SUNAT is proposing a "dual" or "hybrid" model.** Peru has been developing a system for taxing imported digital services over the past several years, holding discussions with international organizations and authorities of countries with experience in that regard. The proposal largely reflects international consensus. The model's core component would be a system for voluntary (electronic) registration by non-resident digital service providers with SUNAT. Registration would not lead to permanent establishment in the country. Providers would pay tax electronically in foreign currency, with the payment being definitive (no entitlement to credits). The system would be simple, without the obligation to issue receipts or keep accounting books and records, for example. In short, this is the regime recommended by international organizations. Another component of the proposed system is the option to charge tax, if the provider did not, through the financial institution making the payment.

131. **Where the digital company does not register with SUNAT, the model provides for an alternative.** SUNAT has a list of approximately 40 digital service companies operating in the country from abroad that it would expect to register in order to pay the tax. However, if they fail to register, SUNAT would notify financial intermediaries in Peru through which local consumers make payments for digital services to withhold the IGV. This practice has been adopted in various countries (among

⁵⁹ This model of requiring digital service providers to have a legal representative in the country has also been adopted by some European countries outside the EU.

others and is not necessarily the most frequent) to require compliance with the tax obligation.⁶⁰ The withholding would be limited to payments made by persons without a business Unique Taxpayer Registry (*Registro Único de Contribuyentes* – RUC) number.⁶¹ There is no threshold for IGV-exempt digital transactions. This alternative in cases of noncompliance is slated to be implemented two months after the possibility of registering on the SUNAT portal is made available to digital services providers.

Limitations of the Proposed Regime

132. **One common issue faced by regimes that tax digital services is the variety of provider business models.** The service subject to the tax would vary depending on the type of business model, and it is not always clear which service exactly should be subject to the IGV. One type of remote business is the sale of strictly digital products, such as access to video games, music, books, and games of chance. In this business model, the entire payment would normally be subject to the IGV. However, in other cases, the digital provider is a platform that operates as a market between third parties, where the digital service in question is the intermediation, the formation of a market, and not the underlying transaction. The price of the service is a fee charged by the provider. This scheme is replicable for the provision of services, be it transportation or accommodation, for example. There will be cases where the reference fee is not clearly identifiable because it is unclear who would pay it: the end consumer of the digital service or the provider of the underlying service. The regulation should contain a general definition of the services included, in addition to two explicit lists, one of taxed and the other of untaxed digital services, which would give taxpayers certainty (Brondolo and Konza, 2021, p. 7).

133. **The definition of taxed digital services will have to safeguard the neutrality of the tax.** Some transactions are expressly exempted under the law. For example, the sale of books is exempted (Law 31053, Art. 29), as are scientific and educational journals. In principle, equivalent digital consumption should have the same tax treatment, unless the digital version is considered to be a materially different product.

134. **The proposal leaves the importation of movable property (B2C) purchased online out of the tax.** Tax would in principle be charged at customs, if the good does not have the benefit of being tax-deductible because it is an “expedited delivery” (parcel) with a maximum value of US\$200 per shipment.⁶² Although the exemption originates in the simplification of the customs procedure, IGV evasion via this route can be significant today. Eliminating this exemption and requiring the digital platform to withhold and remit the tax can be an ideal opportunity to decrease informality without raising customs administration costs. The proposal in the MEF initiative to reduce the

⁶⁰ See Brondolo and Konza (2021), p. 12.

⁶¹ The list provided to financial intermediaries would also include foreign providers that, while registered with SUNAT, fail to fulfill their obligation to remit the tax for whatever reason.

⁶² Law 29774, Art. 1.

deductible (“streamline the scope”) per shipment would instead entail an additional administrative cost.

135. **Eliminating the exemption and making digital service providers responsible for withholding and paying the tax poses a significant challenge.** The Free Trade Agreement between Peru and the United States has been interpreted as protecting the IGV exemption under the terms of the law in force at the time of signing of the treaty. This interpretation (applicable only to trade with the United States), regardless of its legal virtue, would appear to give authority to a trade agreement for an internal tax in Peru, which would not be a best practice. The increasing evasion that the digital procurement of imported products could now represent warrants revisiting the topic.

136. **The potentially more troublesome aspect of the proposal is withholding through the financial system.** The intent of the proposal is for this to be a primarily dissuasive provision and for its application to be unnecessary in practice, except in exceptional circumstances. The regulation will thus have binding force and will encourage voluntary registration. However, as reported to SUNAT, there are large digital companies whose policy is not to register where they have no physical presence. Most likely, the measure will have to be applied in more than one case.

137. **IGV withholding through financial intermediaries has its limitations.** The tax administration must periodically update the list of providers to whom the withholding must apply. This is not easy to oversee. For example, services can be provided by a branch or subsidiary under a name other than that which is listed. Evasion is not difficult for consumers with credit cards issued by non-resident institutions.

Recommendations

- Introduce in the regulation a clear, general definition of the digital services that would be included in the IGV collection mechanism, in addition to a list of examples of the types of included and excluded services.
- Standardize the treatment of the digital service with the equivalent physical transaction, such as books, except if the digital consumption is considered a materially different good.
- Explore the possibility of eliminating the IGV exemption on express delivery shipments (parcels) and replace it with an IGV collection and remittance system for which the digital service provider, that is, either the direct seller or the intermediation platform, would be responsible.
- Re-examine the interpretation that the Free Trade Agreement with the United States that would protect the IGV exemption on imports of “express delivery” (parcel) goods with a maximum value of US\$200 per shipment.

Annex I. Background Data on Chapter III

Table A1. OECD Countries: Revenue from Income Tax on Capital Gains
(Individuals, selected years)

Country	In millions of U.S. dollars			% of GDP			As a percentage of tax revenue		
	2010	2015	2018	2010	2015	2018	2010	2015	2018
South Korea	7	10	16	0.6	0.7	1.0	2.8	3.0	3.6
Denmark	57	42	42	0.0	0.0	0.0	0.0	0.0	0.0
Slovenia	4	3	4	0.0	0.0	0.0	0.0	0.0	0.0
United States	59,481	175,446	210,457	0.4	1.0	1.0	1.7	3.7	4.2
Greece	89	120	145	0.0	0.1	0.1	0.1	0.2	0.2
Ireland	457	742	1,171	0.2	0.3	0.3	0.7	1.1	1.4
Israel	178	638	807	0.1	0.2	0.2	0.3	0.7	0.7
Italy	9	3	0	0.0	0.0	0.0	0.0	0.0	0.0
Lithuania	44	55	102	0.1	0.1	0.2	0.4	0.5	0.6
Netherlands	293	264	172	0.0	0.0	0.0	0.1	0.1	0.1
United Kingdom	3,887	8,529	10,400	0.2	0.3	0.4	0.5	0.9	1.1
Sweden	4,796	8,193	7,979	1.0	1.6	1.4	2.2	3.8	3.3
Average				0.2	0.4	0.4	0.7	1.2	1.3

Source: OECD Global Revenue Statistics Database. Note: Other OECD countries do not record tax revenue for this item.

Table A2. Peru: AER for First, Second, Fourth, and Fifth Category Income Tax, 2020
(by UIT income range)

Income range (UIT)	AER (as a percentage of gross income) on income in:					
	First category	Second category	First + second categories	Fourth category	Fifth category	Fourth + fifth categories
0-1	5.4	5.0	5.2	0.2	0.0	0.1
1-2	5.3	5.0	5.2	0.2	0.1	0.1
2-3	5.2	5.0	5.1	0.3	0.1	0.1
3-4	5.2	5.0	5.1	0.3	0.1	0.1
4-5	5.2	5.0	5.1	0.4	0.2	0.2
5-6	5.1	5.0	5.1	0.5	0.2	0.2
6-7	5.1	5.0	5.1	0.7	0.5	0.5
7-8	5.1	5.0	5.1	0.9	0.8	0.8
8-9	5.1	5.0	5.1	1.4	1.5	1.5
9-10	5.1	5.0	5.1	1.7	2.2	2.1
10-15	5.1	5.0	5.1	2.8	3.7	3.6
15-20	5.1	5.0	5.1	4.6	6.3	6.0
20-25	5.1	5.0	5.1	5.6	8.0	7.5
25-30	5.1	5.0	5.1	6.2	9.1	8.6
30-35	5.1	5.0	5.0	6.5	10.1	9.5
35-40	5.1	5.0	5.1	6.6	10.9	10.2
40-45	5.1	5.0	5.1	6.8	11.6	10.8
45-50	5.0	5.0	5.0	6.7	12.3	11.6
50-55	5.0	5.0	5.0	6.5	13.0	12.3
55-60	5.1	5.0	5.0	6.5	14.1	13.2
60-65	5.1	5.0	5.0	6.7	15.3	14.4
65-70	5.1	5.0	5.0	6.7	16.2	15.2
70-75	5.0	5.0	5.0	6.3	17.1	16.0
75-80	5.1	5.0	5.1	6.8	17.7	16.6
80-85	5.1	5.0	5.1	6.7	18.3	17.2
85-90	5.0	5.0	5.0	6.8	19.0	17.8
90-95	5.0	5.0	5.0	6.2	19.3	17.9
95-100	5.1	5.0	5.1	6.7	19.7	18.5
100-150	5.0	5.0	5.0	6.6	21.2	19.8
150-200	5.0	5.0	5.0	6.7	22.7	21.3
200-250	5.0	5.0	5.0	7.0	23.3	21.7
250-300	5.0	5.0	5.0	7.6	23.8	22.0
300-350	5.1	5.0	5.0	6.8	24.1	22.5
350-400	5.0	5.0	5.0	6.5	23.7	21.7
400-450	5.1	5.1	5.1	6.9	24.3	21.9
450-500	5.1	5.0	5.0	6.3	23.2	21.1
500-600	5.0	5.0	5.0	7.9	24.3	21.5
600-700	5.0	5.0	5.0	7.3	24.3	22.0
700-800	5.2	5.0	5.1	7.1	25.1	22.6
800-900	5.0	5.1	5.1	5.0	22.6	19.6
900-1000	5.1	5.1	5.1	7.7	23.9	22.0
1000-1500	5.0	5.2	5.1	7.8	23.6	20.7
1500-2000	5.1	5.0	5.0	6.9	22.4	19.4
2000-2500	5.1	4.8	4.9	5.8	20.3	13.6
2500-3000	5.0	5.1	5.1	3.9	26.7	17.8
3000+	5.0	5.0	5.0	1.0	22.5	6.2
Total	5.1	5.0	5.0	3.0	5.9	5.4

UIT: Unit of taxation = S/. 4,300 (2020).
Source: Prepared by the IMF mission with SUNAT data (tax returns).

Table A3. Peru: Revenue of First Category Income Tax Applying the Fifth Category AER, 2020

(by UIT income range)

Income range (UIT)	Revenue from first category income (millions of soles)	Fifth category AER (%)	Collection with fifth category AER (millions of soles)
0-1	41.8	0.0	0.0
1-2	83.4	0.0	0.0
2-3	106.7	0.0	0.0
3-4	119.0	0.0	0.0
4-5	130.1	0.0	0.0
5-6	142.1	0.0	0.0
6-7	134.8	0.0	0.0
7-8	123.2	0.8	1.0
8-9	134.4	1.5	2.1
9-10	125.8	2.2	2.7
10-15	554.3	3.7	20.5
15-20	464.7	6.3	29.2
20-25	409.0	8.0	32.6
25-30	351.2	9.1	32.0
30-35	303.3	10.1	30.6
35-40	260.4	10.9	28.3
40-45	243.8	11.6	28.2
45-50	208.8	12.3	25.7
50-55	187.7	13.0	24.5
55-60	186.2	14.1	26.3
60-65	146.9	15.3	22.5
65-70	137.4	16.2	22.2
70-75	125.9	17.1	21.5
75-80	124.4	17.7	22.0
80-85	110.4	18.3	20.2
85-90	94.8	19.0	18.0
90-95	103.5	19.3	20.0
95-100	85.3	19.7	16.8
100-150	621.5	21.2	131.9
150-200	415.9	22.7	94.6
200-250	276.5	23.3	64.4
250-300	216.9	23.8	51.7
300-350	161.0	24.1	38.9
350-400	143.5	23.7	34.0
400-450	121.1	24.3	29.4
450-500	90.9	23.2	21.1
500-600	151.7	24.3	36.9
600-700	94.7	24.3	23.0
700-800	86.5	25.1	21.7
800-900	65.6	22.6	14.8
900-1000	58.8	23.9	14.1
1000-1500	192.9	23.6	45.6
1500-2000	161.3	22.4	36.1
2000-2500	45.9	20.3	9.3
2500-3000	49.8	26.7	13.3
3000+	132.3	22.5	29.7
Total	8,325.9	13.9	1,154.3

UIT: Unit of taxation = S/. 4,300 (2020).
Source: Prepared by the IMF mission with SUNAT data (tax returns).

Table A4. Selected Countries (*): Income Tax on Capital Gains (Except Real Estate) – (Resident) Natural Persons, 2021

Country	Fiscal regime
Germany	Federal rate of 25% + surcharge of 1.375% (exempt threshold: €800 per person, per year). Applies 40% exemption for business activity.
Argentina	Rate of 15% (property, disposal of shares, debt instruments in real local currency or in foreign currency). Disposal of shares on the stock market is exempt.
Brazil	Applies special progressive rate of 15–22.5%. On the stock market, the rate depends on the share's holding period (20% for one day or less; 15% for more than one day).
Canada	The general income tax rate applies to 50% of capital gains, except when the majority of the person's income is from capital gains (in which case the general regime applies).
Chile	The general income tax rate applies. Disposal of shares on the stock market is exempt.
Colombia	General rate of 10%. Disposal of shares on the stock market is exempt.
South Korea	Proceeds from the sale of shares on the stock market are exempt, except if the shareholding is greater than 1% or its value is greater than 300 million won. In this case, the rate is 33% if the holding term is less than one year; otherwise, rates of 22–27.5% apply. If the listed company is small or medium, the rate is 11%. Capital gains from the sale of shares of non-resident companies are taxed at 10% (small and medium-sized companies) and 20% (in all other cases).
Spain	General income tax rate applies. Is limited to the deduction of losses on the disposal of assets from ordinary income.
United States	Short-term capital gains (up to one year): general income tax rate applies. Long-term capital gains (over one year): special progressive rate of 0–15–20%.
Mexico	Fixed rate of 10% on sales on the stock market. Everything else is subject to the general income tax regime.
Netherlands	Capital gains are generally exempt, except when at least 5% of company shares are transferred (in which case a fixed rate of 26.9% applies). If the frequency of transactions exceeds certain parameters, the general income tax regime applies. Moreover, assets are taxed on a presumed income of 4% at 30% when they exceed €25,000.
United Kingdom	Rate of 20% (for persons with income above £37,500); in all other cases, a rate of 10% applies. Capital gains up to £12,300 are exempt.

Source: IBFD. Notes: (*): Selected countries based on position as source of FDI (according to IMF Coordinated Direct Investment Survey – CDIS) in Peru.

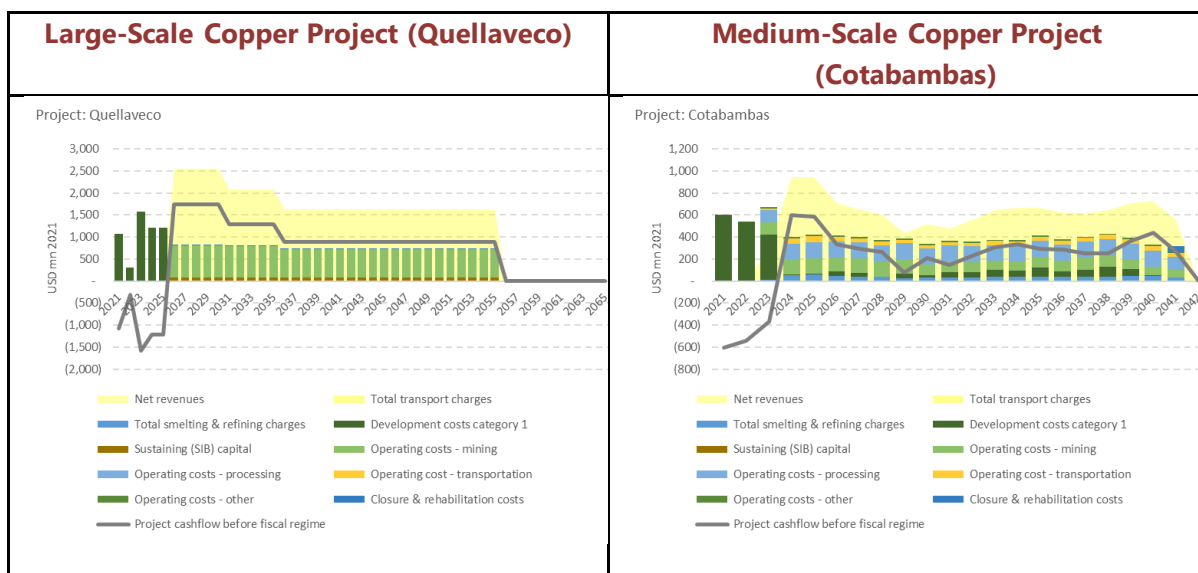
Table A5. Selected Countries (*): Tax on Dividend Distribution – (Resident) Natural Persons, 2021

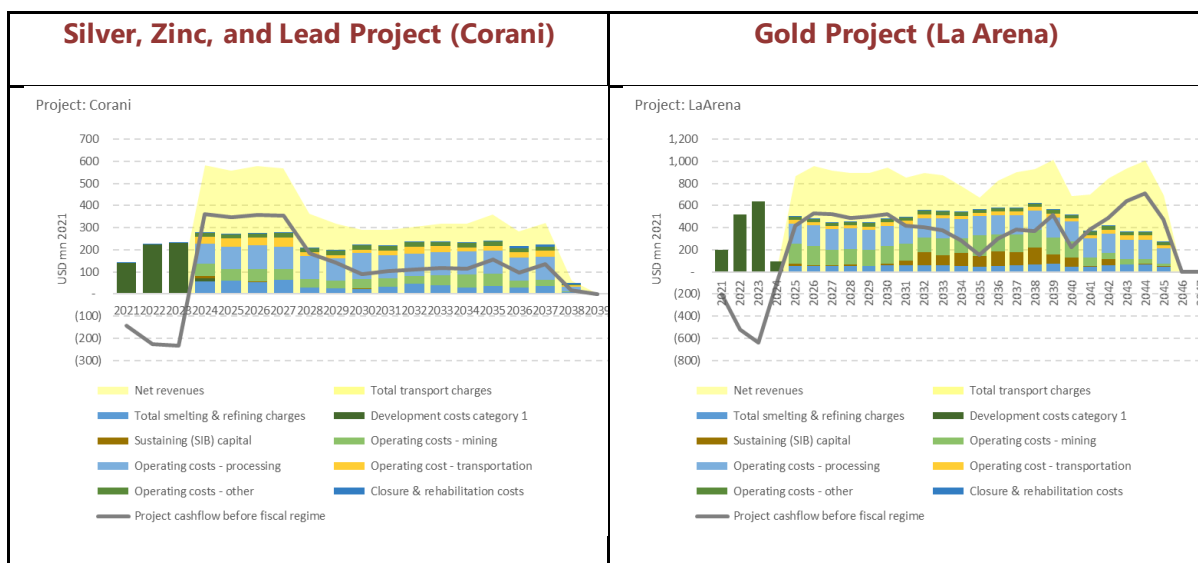
Country	Fiscal regime
Argentina	i) Fixed rate of 7% (dividends received from resident companies). ii) Progressive income tax rate (dividends received from non-resident companies)
Brazil	Dividend distribution is not taxed.
Canada(**)	i) Progressive income tax rate (dividends received from resident companies; corporate income tax rate can be credited). ii) Progressive income tax rate (dividends received from non-resident companies).
Chile(**)	i) Progressive income tax rate (dividends received from resident companies; corporate income tax rate can be credited). ii) Progressive income tax rate (dividends received from non-resident companies).
Colombia	Fixed rate of 10% (dividends > 300 UVTs(***)). Dividend distribution < 300 UVTs is not taxed.
South Korea	Fixed rate of 14% (total income from dividends and interest < 20 million won). Progressive income tax rate (total income from dividends and interest > 20 million won; 11% corporate income tax can be credited).
Spain	Progressive income tax rate; corporate income tax cannot be credited.
United States	Special progressive rate on long-term capital gains of 0–20%. In all other cases, the progressive income tax rate applies.
Mexico (**)	Progressive income tax rate (corporate income tax can be credited) + fixed withholding rate of 10%.
Netherlands	Fixed rate of 26.9% (for persons who own at least 5% of a company's shares).
United Kingdom	Special progressive rate of 7.5–8.1%.

Source: IBFD. Notes: (*): Selected countries based on position as source of FDI (according to IMF CDIS) in Peru. (**): The progressive income tax rate applies to distributed dividend "gross-up." (***) UVT: Tax value unit (*Unidad de Valor Tributario*).

Annex II. Mineral Price, Cost, and Production Assumptions

1. **The IMF mission used public information on mining investment projects in Peru to build production models in the FARI analysis.** Investors listed on public securities markets are typically required to publish detailed feasibility studies on their investment projects. These studies normally include information on production and capital and operating expenses throughout the life of the project. This information can be used to calibrate production models that serve as inputs for cash flow analysis, which is the basis of the FARI analysis. These projects are not intended to be a faithful reflection of fiscal performance expected for any of the projects.
2. **Four production models were built, taking into account three recent feasibility studies and one presentation to investors.** These models include large- and medium-scale copper production projects (with molybdenum and gold as by-products), a medium-scale gold project, and a medium-scale zinc, silver, and lead project. The project selection criteria were as follows: 1) availability of detailed production and cost information, its representativeness in Peru's mining sector in terms of its cost structure and scale and extracted products (to reflect the significance of copper and gold mining in Peru).





3. **Common debt financing parameters representing current undercapitalization rules in Peru are used.** For all projects, the assumption is that development costs are 70 percent financed through a structured loan at a LIBOR interest rate above 5 percent.

4. **The base scenario uses commodity prices that reflect official projections in the most recent macroeconomic framework and current market conditions.** The FARI analysis uses the following assumptions for the constant prices of given minerals in U.S. dollars:

Copper	US\$3.50/lb
Gold	US\$1,550/troy oz
Zinc	US\$1.10/lb
Silver	US\$24/oz
Lead	US\$2,200/metric ton
Molybdenum	US\$22,000/metric ton

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